TWENTIETH CENTURY TEXT-BOOKS

# FIRST LESSONS IN FINANCE

(SCHOOL EDITION OF
FUNDS AND THEIR USES)

BY

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*WITH MANY ILLUSTRATIONS*



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# PREFACE

Except in its public aspects, the subject of finance has received little attention at the hands of writers. The necessity for funds with which to carry on King William's war with France gave rise to the Bank of England and, with it, to modern funding methods. Nearly all of the great banks and banking systems of the past have grown out of *public* rather than *private* needs. So constantly has attention been drawn to funding measures of Government, that the words "finance" and "funds" have come to be associated almost exclusively with public affairs. The fast increasing funds in private institutions, the magnitude of modern industrial and commercial undertakings, the large funding operations wholly private in their character that have gone along with private enterprise during the last decade, have awakened an interest in private finance far exceeding that which attaches to public revenues and expenditures. Recognizing the need for the collection and coordination of data in this branch of the subject, effort has been directed toward the development of a literature such as may bring the facts of financial life within the reach of the reading public. This larger work was undertaken some years ago in cooperation with Dr. Edward S. Meade, of the University of Pennsylvania. The present essay is the

first of a series aiming to give a wide survey of the field of finance.

Looking upon the subject of private finance as one which has to do with the getting and spending of funds for private enterprise, the materials of this book have been grouped around three central ideas, viz.: (1) What are Funds? (2) How Funds are Obtained. (3) The Institutions and Agencies Employed in Funding Operations. The more technical fields of financiering—the several departments of financial operation—are reserved for subsequent essays. In Part I the various forms of money and credit used as funds, and the means of transfer of credit funds, are discussed. An understanding of the nature of funds is regarded as fundamental. Part II, which has for its subject "How Funds are Obtained," divides modern funding methods into two classes, namely, (1) the methods of the industrially and socially dependent, and (2) the methods of the industrially and socially independent—i. e., those who depend upon active participation in business. The only method by which the former may obtain funds is that of *gift and inheritance*, which is the title of Chapter IV; in this the consideration is one of personal attachment and direct appeal. The funding method of the second class, those actively cooperating in industrial life, is that of *exchange*. The consideration for exchange is one of "value." In business there is but one way of obtaining funds—that is, to have something to sell, something for which those having funds are willing to exchange them. To this method several chapters are given. Those without capital or other property must resort to *sales of labor*. The limitations of the laborer, the advantages of education and industrial training, and

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# CHAPTER I

## FUNDS AND THEIR USES—INTRODUCTORY

Among the first ideas that one gets from early association is a notion of respect for the "property" of others; we soon come to know that there is a difference between those things which we may call "our own" and those things which "belong" to another. Parental authority within the family first impresses the lesson; later, association with playmates enforces it. Any attempt to violate what are commonly recognized in the community as "rights of property" brings us to grief. The jealousy with which the child guards his right to use his own top, his own marbles, his own knickknacks, and the respect which he comes to have for things displayed in shop-windows or in the possession of his playmates, illustrate the force with which ideas of property are early impressed upon the race.

*Property.*

No sooner, however, does the child come to know the use of things, or begin to long for objects that attract his notice, than he learns that the "consent" of some one must be obtained before they may be taken. From a parent, a sister, or a brother—members of the household—this consent may be had for the asking; within the family, acquisition takes the form of "gift." From others, however—those not bound by ties of affection or mutual regard—a mere request is not sufficient. In front of a shop is a basket of apples. Their rich

*How property is acquired.*

color and fragrance suggest to the child passing that he would like to have some of the fruit. He asks the shopkeeper—seeks to obtain an apple "by gift," as he had been accustomed to do at home. His request is refused. How is he to obtain the coveted fruit? The shopkeeper helps him out of the difficulty. "Have you a penny?" "No." "If you will get me a penny I will let you have an apple." With this suggestion the boy has his first idea in finance. He runs to his father, obtains a penny "by gift," and, returning, "exchanges" it for an apple. Thus he learns how the "consent" of shopkeepers may be won, and that this is a second method by which the property of others may be acquired.

*Exchange the chief method of acquiring property.*

Exchange lies at the foundation of the world's industrial progress. The story of Crusoe serves well to illustrate the possibilities of life without it. Among a primitive people centuries may be required to obtain the metals needed for weapons and a few rude implements. We have but to reflect upon the many thousands of things about the modern household, each of which contributes a share to comfort or pleasure, to realize how incapable man would be to provide for himself. How long, for example, would it take a man, working alone, to extract from nature a pound of iron? Having the metal in hand, how long must he labor to make a needle or a screw? Few of the common things in use to-day could be had at all; they are each the product of hands whose skill has come from years of experience and training, working with processes and appliances inherited from a society that has labored for centuries past—a cooperative society in which, without exchange, cooperation would have been impossible. In every instance, increased facilities of exchange have led to a wider range of social and industrial activity. To its development we owe the economies of division of labor, the benefits of the factory system, the larger return and more intelligent con-

trol, coming from differentiation and centralization of industries—in fact, every mile-stone of human progress has engraved upon it the significant emblem "Exchange."

Out of exchange arises the necessity for "funds." In business parlance there is probably no word so big with meaning as this one. "If I could get the necessary funds," says the blacksmith, "I would build a wagon shop." The grocer does not add to his stock of sugar when the price is low "for lack of funds." "We are in need of funds," says the building contractor to his partner—"we must have at least $1,000 more to pay our men." "Our funds are running low," says the miller's clerk; "we must realize on outstanding bills, or make some other arrangement to meet obligations maturing on the first of the month." It is out of just such situations and just such problems that the business of finance arises. "Funds" are the key to business under an economy of exchange—a necessary part of business equipment.

*Importance of funds in business.*

Business is said to be a contest in which every one is striving for the same thing. This is not entirely true, yet one has but to look out on Broadway or any main thoroughfare of a great city to be impressed with the fact that some kind of contest is going on. Men are hurrying to and fro, pushing each other about, each trying to get somewhere, to do something one does not know what. But it is evident that each has something very definite in mind and that he is straining every nerve and muscle to accomplish a purpose. What is it that brings these millions into the street, takes them to the shops, causes some to stand behind counters and others to work and sweat before a furnace? Each seems to be working and striving in a different way, but if you ask the clerk or the foundryman, the day-laborer or the banker, what he is striving for, each will make the same answer. "I am not in business for my health," is a saying which expresses a great deal of truth. Each one has certain wants and desires

*What is business?*

to satisfy. On all sides are found the requisite materials. To *gain* those things which will satisfy desire, *in an orderly and peaceful way*, is the aim of business. Under an industrial *régime*, based on exchange, the quest of business is for "profits." The success of a business enterprise is measured by its "profits"—i. e., the gains to proprietors made through it. Profits, however, are measured by the standard of increased or decreased ability to resolve one's property into funds.

*Necessity for law and order in business.*

A peaceful contest must have rules to govern it, for without rules there would be violence between parties. A number of marbles are placed within a ring; a line is drawn, behind which each player must stand for the first throw; the one who lands his marble nearest the center takes first shot. So the rules are laid down for the beginning of the game. After the contest is over each counts the marbles which he has driven out of the ring. Each player has put in two marbles as "counters." At the end, one has scored three; he is one marble ahead, while the other player has driven out but one—he has lost a marble. There must be a rule for every possible situation and every point at issue, otherwise the game could not proceed. The one boy would not allow the other to take his marble (his property) unless he did it according to rules understood by both at the beginning. The same is true of football, baseball, lacrosse, every contest for points. Not only must the rules be known, but they must also be strictly observed. In case of a dispute as to what the rules are, or how they should be applied, the parties may come to a subsequent agreement, or, failing in this, they may refer the point at issue to some one not in the game who knows the rules. He who does not play "fair" may have some of his points taken away, or, on continued offense, may be "ruled out of the game."

Business is a contest in which the "counters" are money. Business law is nothing more nor less than the

rules governing the contest. The honest man is the one who plays according to rule. A law-breaker not only runs the risk of losing points (i. e., of being "penalized") but he may be "ruled out." This may be done by his fellows refusing longer to do business with him, or by his being "locked up,"—put in jail as often as he breaks the rule. Business may be a very large game. The whole world is the field, and its rules must be understood and observed by all who come into common business relations.

*Business law.*

The laws of business must be common to all people trading together. It sometimes happens that those known as civilized people attempt to do business with others who do not understand their rules or who have different ones. This is like two sets of players entering a football contest, the one trying to play "association ball," and the other trying to play "rugby." Two systems of business come into conflict. The rules of the one people must be made to conform to those of the other or else there will be trouble. The common advantages of trade are so great that no one industrial group can afford to shut itself off. In fact, no barrier is strong enough to preclude men from following up a business advantage when it presents itself. This brings the people of all nations into constant contact. In the conflicts between systems, the stronger forces the weaker to change its rules. The importance of obedience to rules of business law is so great that nations as well as individuals are made to suffer by what is deemed a violation of them. That "honesty is the best policy" is a saying trite but true. Whatever may be said of the attitude of one nation toward another, no single individual can afford to raise even a suspicion of dishonest conduct, as this would cut him off from opportunity and preclude him from the advantages offered by broader cooperation with his fellows, cooperation made possible by confidence in fair dealing. To quote a saying of Mr. Croker, the Democratic leader of New York: "No combination can be made where

all are dishonest and each one knows it. The first element of leadership is honesty, perfect honesty. The honest man will prevail because other men will trust him. A rascal can trust an honest man, but a rascal can not trust a rascal. You may take one hundred men, ten of them honest and ninety of them false, and put them away on an island; come back in two months and, for the reasons I have given you, you will find the ten men dominating the rest." While Mr. Croker is not often referred to for standards of morality, his success as a politician has depended very largely upon his recognition of the advantage of strict integrity among his political followers, and the advantage of fair play is even more striking in business organization and control.

*Elements of success in business.*

In a game, two conditions are prerequisite to success: (1) An intimate knowledge of its rules; (2) Skill in the use of the instruments employed. A knowledge of business laws, and skill in the use of the instruments and agents by means of which "gains" are to be made, are just as necessary to business success. To the laborer—the one who relies for income on the sale of his labor, who subordinates his own business or talent to help another work out his schemes for gain—a general knowledge of law may be of less importance than skill in the use of some particular tool; but he must know enough of the rules to play his part well, otherwise he will not be able to render service to the manager to whom he engages himself. The man who manages a business plant and seeks income from the sale of its products must equip himself in a different way. He may have less skill in the use of some particular instrument than has the man whom he employs, but he must know the use of instruments, and know the manner in which they may be used by others to the highest advantage in order to direct the efforts of his working force in such a manner as to make largest gains without breaking rules. Like a football cap-

tain, he must know how to manage his men and his plant so as to take advantage of every opening. Business is co-operative. A man can not do business alone. He must play a part. He must be properly equipped for whatever part he plays. Business training, knowledge of the law, equipment adapted to the enterprise, materials, services, all are necessary, but in obtaining these the first need is for "funds." The acquiring of funds (capital), therefore, may be said to be the first step in providing for business equipment and business success.

*Funds a necessary part of business equipment.*

Children are frequently found on the street asking for pennies. They have learned the use of money as a means of obtaining things desired, but they have not yet risen above the most primitive knowledge of how to get money. Their fathers and mothers may provide it by gift, as they would also provide the things which pennies will buy, but those not moved by affection or, as sometimes happens, by charity, turn a deaf ear to appeals of this kind. In early years, "gifts" based upon affection afford a means quite adequate, except in cases of inability of parents to provide. Generally speaking, girls and women throughout their lives are limited to this means of obtaining funds. Many men also pass their lives in this fashion—they obtain all things desired by means of funds contributed. Those who may not depend upon endowments of ancestors, and those engaged in active business, have quite different financial problems to solve. Finance is that branch of business which has to do with the getting and spending of funds necessary to the equipment and management of enterprise. A student of finance must first consider what is meant by "funds." When a business man says that "his funds are running low," what does he mean? Does he mean that his money is nearly all gone? Perhaps he has not had more than a dollar in his purse for a week, and has had no particular use for that, yet he has been car-

*Funds, the subject of finance.*

rying on a large "cash" business all the time—has had no lack of "funds." What are "funds"? How are they obtained? How are they managed? These three questions answered, the whole field of finance will have been covered.

# PART I

# WHAT ARE FUNDS?

## CHAPTER II

### MONEY FUNDS

Experience will at once suggest that what we call "funds" must be something that will be accepted by others *in exchange* for their goods or services—i. e., something that others regard as valuable to them in their own business transactions. Those things which will serve as "funds" to one, must have such qualities that they will serve as "funds" to others. By way of illustration let us suppose that a blacksmith in Springfield wishes to enlarge his business. To that end he begins to accumulate a store of horseshoe nails. Each week he lays by twelve pounds of nails, until at last he has a ton of them. This might serve as "funds" in a community where every one desires horseshoe nails, but in Springfield not one in a thousand can make use of them. With this stock in hand he is not able to buy bricks, lime, or machinery, or pay for labor. Horseshoe nails are not "funds" in Springfield. The blacksmith, however, finds a man who can make use of a ton of nails; he exchanges them for ten double eagles of gold. He has sold his nails for no other purpose than to obtain something that will serve as funds. With $200 in gold he may purchase the materials and equipment desired. He has "funded" his enterprise.

The whole system of finance grows out of the economy of exchange. Where commerce exists as a feature of business enterprise, where each member of a community strives to do that for which he is best fitted, and where each relies

on exchange of things produced for other things desired, it is to the advantage of each to provide himself with "funds" with which purchases and payments may be made. A "fund" is a collection, or store, or amount of something by means of which purchases and payments may be made. The word "funds" signifies any and all things which may be accumulated and which may be currently used in a community in exchange for goods or properties of others. As has been suggested before, the consent of both parties is necessary to an exchange. That which will serve as funds must have qualities which will induce others to give their consent to part with the things which they own, in exchange. Funds that are collected or stored up to pay living expenses, or for the purchase of comforts and enjoyment, may be called "maintenance funds." They answer the same purpose for an individual that a fund would when laid by for the "maintenance" of a manufacturing plant. Funds that are collected or provided for business equipment are called "capital funds." The capital of a business concern is made up of funds contributed to it for permanent use. A money or a credit reserve laid by for the payment (sinking) of a debt is called a "sinking fund." When money is stored up for the purpose of hiding it away, and not for use, it is called a "safe deposit" or a "hoard." This, however, does not properly come within the field of finance. To "fund" an enterprise is to provide the means whereby such purchases and payments may be made as are necessary to its success. One whose business it is to provide funds for business enterprise is called a "capitalist"; the manager of funds is a "financier"; he who hoards money is a "miser." A "funded debt" is one for the payment of which some definite and adequate provision is made for funds when due. To illustrate: *A* borrows $1,000 from *B*. *A* thereby procures "funds" for his enterprise; he funds his undertaking; he secures a working capital of $1,000. The

*Definitions—Funds.*

instrument employed to this end is a contract for the future delivery of money which he sells to *B* for the funds desired. But before *B* delivers the $1,000 to *A* in exchange for the note, he demands that some definite provision be made for its payment. Complying with this demand, *A* executes a mortgage on his farm as "security" for the payment of the note. The mortgage is a conditional deed to his land, the condition being that in case *A* fails to pay the note when due, *B* may sell the farm, and out of the "funds" thereby obtained retain enough to pay the note. In other words, *A* sets aside property in trust, the sale of which will create a fund sufficient to pay his debt.

*Two forms of funds.*

Funds may be divided into two classes: (1) Those things which pass in the community as money; (2) forms of credit, or contracts for the future delivery of money. These may be given and accepted for the purpose of making purchases and payments. Both of these forms are a part of a money economy. Under a system in which credit is used as a means of purchase, the necessity for actual delivery of money is in large measure avoided. Instead of "money funds" being kept on hand by each member of the business community, a few individuals or institutions hold a large store of money "in reserve," and the business community makes its arrangements with them for forms of credit which will serve their financial needs more readily than money itself. The money demands and money uses are largely demands for and uses of money for settlement of credit balances. In all modern systems of finance, by far the greater part of business enterprise is "funded" by means of credit. The manner in which this is done will appear later.

## Money Funds

Two qualities or characteristics are essential to money. *In the first place*, those things which are used as money within a given community must exist in such quantities as

to allow the various members of the community to collect them into "funds" large enough to make the purchases and payments necessary for their business undertakings. A people can not use as money that which they do not possess; the thing employed must exist in such quantities that it may be had when needed. *In the second place*, the money commodity must be so highly valued by all that it will readily be taken in exchange for goods offered for sale. No two persons may place the same estimate of value upon it; judgments of value of the money commodity may differ as widely as its various uses, but value it must have in the judgment of all with whom exchanges are to be made. Otherwise a business man could not get together, or offer, enough of the commodity to cause another to think that he would profit by an exchange.

*Essential characteristics of money.*

## Conditions on which the Fundability and Value of Money Depend

To this end the things accumulated for use as money must admit of being divided with such accuracy as to enable one readily to calculate the amount or portion on which his judgment of value is to be based. If, for example, some one offers a horse for $100, it must be known at once just how much gold is intended before one can form a judgment as to whether he would prefer the gold or the horse. The money offered must admit of division into comparatively uniform units. In a pastoral community sheep may be used as money; a flock of sheep may be divided into units. One hundred sheep or fifty sheep have a very definite meaning. There is uniformity enough about the primitive sheep to satisfy the judgment of the primitive man. Then, instead of judging the comparative values of a goat, an ox, a horse, and a stack of fodder in terms of dollars as we do now, the party having all of these

*1. A money fund must admit of division into units.*

things for sale might offer the goat for 5 sheep, the ox for 10 sheep, the horse for 20 sheep, and the stack of fodder for 15 sheep. Each member of the community having sheep would then have to consider whether 5 sheep would be of greater value to him for purposes of trade or for other use than the goat; whether 10 sheep would be more useful than the ox, etc., and on the result of his judgment, in the bickerings among those making estimates and offers, would depend the agreement as to price.

*2. Money funds must be uniform in quality.*

Since prices must be made and quoted in terms which will be understood by others, it becomes necessary to have some common standard of judgment in estimates of value. Without such a standard one trader would not be able to make himself understood by another. If I were to ask you the value of a certain piece of land, you would not be able to express your thought or conclusion in answer to the question unless you could appeal to some standard or measure of value which was known to me. The same is true in making a trade. In this case the one offering goods for sale does not volunteer his estimate of value, but by offering the goods for a definite sum of money both parties find in the price a common standard for judgment. Unless, however, the money funds in which the offer is made are uniform in quality there can be no judgment as to the relative value of the thing offered and of the price to be received. In other words, as between the various units which go to make up the money fund, the judgment of value must be practically the same. Without uniformity, such expressions as a dollar, a sheep, a bushel of wheat, or whatever the thing used as money, would have no uniform meaning.

The thing used must likewise have such durability as to protect it from immediate decay. There must be no fear of loss or damage while the thing used is held in the form of funds. Lack of durability would render uncertain all

judgments of value for future use. It would make exchange itself so far a subject of chance as to render impossible all estimates of an advantage to be "gained" from a business transaction. When calculation of value for future use is made difficult, exchange as a regular part of the industrial system is hampered.

*3. Money funds must have durability.*

Money funds must be adapted to being carried about or passed from one person to another without great inconvenience. Nothing can serve as money unless the fund accumulated can be easily handled. Lands, houses, and country estates can not be used on this account. There are other qualities which may add to the value of a thing to be used as money, but the foregoing may be said to be necessary to adapt it to the purposes of exchange. Each and all of these qualities must be possessed to some extent. Some things are more easily carried about than others; some are more durable than others, while some may be more uniform or more easily divisible, but no one of these characteristics must be wholly wanting in the thing used as money. The greater the degree in which all are present, the more serviceable will be the substance employed.

*4. Money funds must admit of being carried about.*

## Things that have been used as Money

In a given community those things will be used for money that will give greatest ease to exchange. Among one people, each family may grow a little corn, may have a few horses or cattle, may possess various rude weapons or utensils for domestic use, may also have provided for themselves shelter. They, however, are a hunting people; meat is perishable; for long periods they may be entirely without corn. At times horses may be had, but they are not obtainable by all; weapons are in great variety and size, and adapted to the strength and skill of those using them. The tribe is migra-

*Skins.*

tory and often changes its location. Among such a people the things best adapted to serve as money may be the skins of animals.

*Dried fish.*

Another people may live under quite similar conditions, except that they get a large part of their substance from fishing. The things that best lend themselves to their use as money are dried and smoked fish or clams. These will last for years, and there is always a demand for them as food. When fish are scarce the dried products will be more highly valued; when plentiful, they will be prized less; but at all times they will have some value due to their usefulness and to the labor entailed in procuring more.

*Live stock.*

Under other circumstances a people may develop a pastoral life. With them their flocks and herds furnish that which serves them best as money. Many of our financial terms have come from such a practice: *pecus* was the Latin name for kine—cattle; *pecunia* came to be the Latin word for money; we have from this such words as pecuniary, pecunious, impecunious, peculation, etc. They counted their money (cattle) by the head (per capita), and their kine were their *capital.* Our money is our capital; our goods are our chattels; our kine are our cattle. In old England *scot* was a tax or fee; this presumably came from the Saxon *scot*, meaning cattle, and "scot" was used when taxes were paid in kind. Our expression, to go "scot free," comes directly from this use of the word —that is, free from taxes or fine.

*Agricultural products.*

In communities where agriculture prevailed, some forms of agricultural products were found to be most serviceable in making exchange; wheat, oats, and barley were used in Europe for centuries; maize was employed among the Indians of Central America; where olive-oil, cakes of dried fruit, cocoanuts, and tea have been largely produced they have served peoples as a means of exchange.

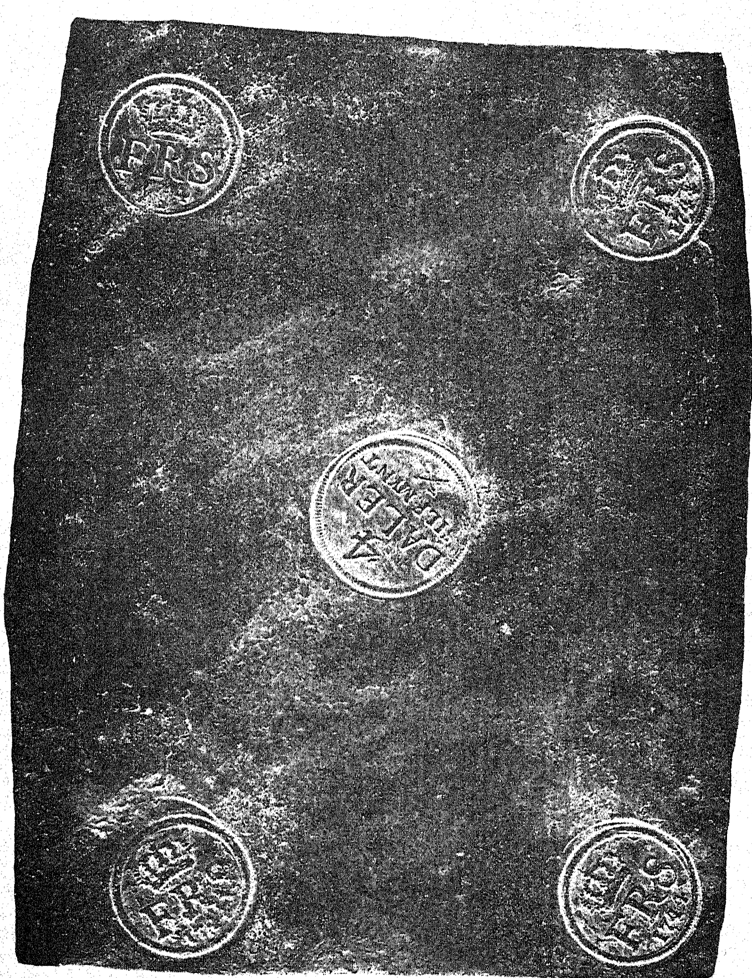
Both the advantages and disadvantages of the use of these primitive forms of money are apparent. By their use many of the economics of exchange were secured and many of the difficulties of barter were overcome; but still commerce could not be carried on with ease. All of the things used possessed the qualities essential to money, but none possessed them in high degree. All had qualities which caused them to be valued, but judgments of value varied widely with each individual. All admitted of division, but division, in most cases, could not be made with exactness. There was little uniformity, therefore judgment was hampered as to the value of a unit of kind. Their durability was not great. Many of them could not easily be passed about from hand to hand. Yet, with all these faults and disadvantages, they were the best that the people using them could provide; it required centuries of social and industrial progress for these peoples to acquire those things which would serve them better.

*Advantages and disadvantages in the use of these forms of money.*

Every increased facility given to exchange gives a wider range to social, political, and industrial activity. With the growth of intelligence, with the higher development of industrial processes and artistic skill, metals were brought into use which possessed qualities better adapted to serve as funds. Copper, tin, iron, zinc, brass, and other alloys, came to have currency. Even when these were comparatively scarce, they were to be had in such quantities as to allow the accumulation of "funds" sufficient to serve the community in exchange, and were so far superior to agricultural products that the latter became supplanted. Iron was at one time used; but when iron came to be so plentiful that it was used for weapons, household implements, plowshares, etc., the estimate placed on the value of iron, as compared with other things, was so small that one could not easily accumulate and carry about a fund large enough to make

*The base metals.*

the necessary purchases of the goods. Thus, with increased use of iron for other purposes, it became unfit for use as



money, because of the great amount necessary to an exchange—i. e., it lacked so far the element of convenience

that other metals were preferred. In time, the same came to be true of tin, zinc, and to a large extent of copper, brass, nickel, and other metals. A good illustration of the inconvenience attending the use of copper is furnished in the cut on page 19. The copper sheet from which the engraving was made is 14 inches long, 9 inches wide, and weighs 7 pounds. It bears the stamp of a Swedish sovereign. It may be called a Swedish four-dollar-bill of 1744. Imagine taking a few of these to market to do a little shopping!

*Ornaments.*

Strange as it may seem, the world's best moneys have come from materials used for ornament. This, however, follows naturally. The desire for ornamentation is general. It arises out of a desire for distinction among one's fellows. Those things that are used for decorative purposes are things not common. Things that will serve a particular people for ornament will be desired by all—that is, they possess qualities which will cause them to be highly valued. In both money and ornament the element of value brings them into close relation. If the things desired for decoration possess the other qualities essential to money, the two uses may be concurrent. Fishermen have polished the vertebræ of fish and used them for beads; the American Indian has polished the ends of black and white shells and strung them; wampumpeag (sometimes called wampum, or peag) was used for money by the Indians. In Massachusetts, when the money which the English people were used to became too scarce to serve them in their exchanges, they reverted to the use of the Indian wampum; the general court of that colony made this legal-tender currency among the settlers at a fixed rate to the amount of 40 shillings. Ornaments of various kinds have been used for money. Many of them have great durability; they accumulate from one generation to another until they are possessed by members of the tribe in quantities sufficient to answer the purposes of money. When these things serve exchange better than the less

durable products, they often come to be the only money used.

*Gold and silver.*

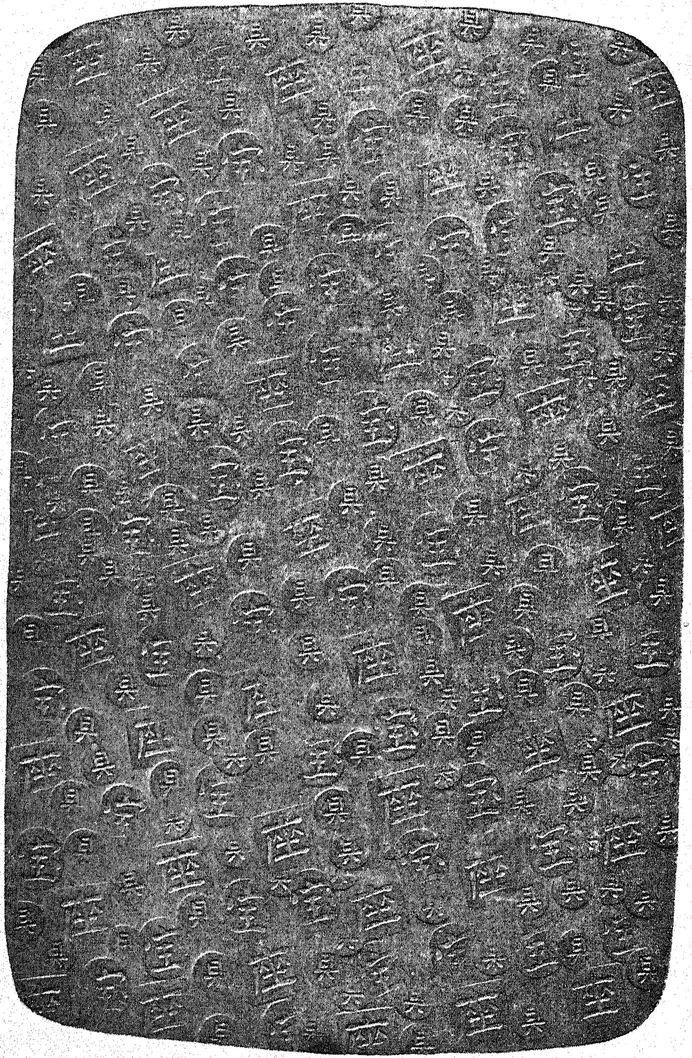
Gold and silver were first used for ornament alone. For many centuries they were too scarce to serve as money—to be accumulated as money funds. This is still true among some peoples. These metals finally came to be the generally accepted money in civilized nations. Under modern industrial conditions these metals are in every way better adapted to money uses than other materials are. They are universally prized; they admit of accurate division, and units of value may be exactly determined; they are easily refined, and may be given exact uniformity of quality; they have great durability, do not easily corrode; they exist in quantities sufficient for currency, but are not so plentiful that it is necessary for a trader to encumber himself in his effort to have on hand a store large enough to effect exchange; funds of gold and silver being highly valued may be easily passed from hand to hand. For these reasons they are more useful as money in civilized communities than the "baser metals." They also serve better than the other "precious" metals; better than platinum, because platinum is too scarce; diamonds and precious stones are easily broken and destroyed, are not divisible into equal parts, are not uniform in quality. Gold and silver not only possess the qualities essential to money in a high degree of perfection, but also admit of stamps and other marks of authority which give certainty as to weight and fineness. Coins made of these metals are easily distinguished from counterfeits; they have characteristics which permit traders most easily to arrive at a conclusion as to value and to agree on a price.

With all primitive people several commodities are indiscriminately used as money. Such a money system multiplies the difficulties of exchange. If skins be used, then an ox may, by one man, be estimated as having a value equal to 10 bearskins; another may compare the value of

the ox to 20 raccoon skins; a third may use the fur of the mink as his basis of comparison; a fourth, having an assortment of skins, might offer 2 bearskins, 6 raccoon skins, 10 mink skins, and 15 skunk skins. With such a money it is difficult to come to a conclusion in trade. Commercial transactions become involved; the bickering necessary to a sale is a long process. Exchange with such a money would be little better than barter. Metallic money may quite as much encumber a transaction. Before the development of a system of exact coinage the money metals often had stamped upon them marks of private houses or of government which guaranteed their fineness. They were then clipped up or cut into pieces to serve the purposes of the transaction in which they were used. The illustration on the next page is a copy, slightly reduced, of a Japanese sheet of silver bearing such marks of guarantee; in whatever way it might be cut, each piece would still carry with it a stamp. After a system of exact coinage was introduced, the problem of the different values placed upon each metal had still to be solved. A gold coin and a silver coin might each bear the stamp of "one pound sterling," yet each would pass at a different valuation. Each metal added to the currency increased the confusion. Attempts have been made to avoid this trouble by using a fixed legal ratio between coins of different materials. Such devices, however, have often proved futile, for traders were constantly passing judgment on the comparative values of the coins used, and when the values of these did not correspond with the ratios intended, each stipulated the metal he would receive in exchange. After many failures, an expedient was hit upon which allowed several kinds of money to be used at the same time and all of the estimates of value to be compared with one metal. This was done by what is known as "the establishment of a standard." In a complex system of money, the standard is a coin composed of a certain amount of metal of a particular kind, having

*The development of a standard.*

prescribed weight and fineness, for which all other coins may be exchanged at a fixed ratio. The weight and fine-



ness of the other coins are also prescribed, but it is by a process known as redemption that their relative values and ratios of exchange are maintained. It is this device that lies at the foundation of modern graduated systems of money.

*The decimal system.*

As before observed, the evolution of the modern money system is a long and involved process, one dependent upon the development of higher intelligence, broader association, and improved methods of social, political, and industrial cooperation. With modern methods even barter would not be as cumbersome as money exchange under more primitive systems. In fact, modern facilities for comparison of wants and of goods by advertisement and other means of intelligence, allow of many things being exchanged by a system of barter in preference to sale and purchase. Some newspapers and circular publications are devoted to this, and their support is the best testimonial to their success. With all our improved processes, however, with all our modern adaptations, there are still many of the old difficulties that persist. A comparison of the complex, lumbering English system of money with our own will serve to illustrate the economies introduced by later experience and better adaptations. Exchanges and accounts in pounds and shillings and pence necessarily burden English commerce with an enormous expense of time and energy. It is a burden similar to a tax on trade. If the amount of time that is saved to our nation by the decimal system of money were to be computed, the result would be startling. Let us assume that, by means of the decimal system, twenty minutes per day were saved to those engaged in commercial transactions and accounts; with 5,000,000 people employed in this manner, there would be an economy of over $100,000,000 per annum. In the United States, however, we are still encumbered by older systems of weights and measures. It is to be hoped in the interest of economy that a decimal system

may ultimately be adopted for these calculations. Another economy in exchange that has been worked out by Americans comes through our broader social, political, and industrial organization. Throughout the United States and Canada we have practically one standard and one system of money. The business of this Continent is freed from the multiplicity of computations necessary to deals in Europe and other parts of the world. Gradually the world is working toward uniformity in standards and uniformity in monetary systems. The result is a higher economy—increased facility in making commercial judgments, and increased advantage in commercial exchange.

## The Money System of the United States

*The "dollar" —The central fact in our system.*

The central idea of the American money system is the "dollar." What is a dollar? This question has been the subject of volumes of discussion. The answer to the question has become involved in a wilderness of theory—lost in a maze of abstractions—as a result of which the reader is led to believe that there is great difficulty in understanding just what a dollar is. Fortunately we do not have to read all this literature and wrestle with all the hypothetical problems propounded. The whole matter is settled by one section of the United States statutes. The Act of February 12, 1873 (Sec. 14), establishes "25.8 grains of gold" $\frac{900}{1000}$ fine (or 23.22 grains of fine gold), which bears the required stamp and impress. The statute says that this *is* a dollar—not that it resembles a dollar, or that, for the purposes of discussion, it may be considered a dollar, but that it *is* a dollar. Furthermore, the statute again cuts off all controversy regarding the worth of a dollar; for it says that the dollar (the printed piece of gold containing 25.8 grains of gold $\frac{900}{1000}$ fine) "shall be the *unit of value*" in our money system.

But what about the other forms of money in our complex system? In the first place, there are six kinds of gold coin, viz., the "dollar," the "quarter-eagle," the "three-dollar" piece, the "half-eagle," the "eagle," and the "double-eagle." What about these? They must contain exactly the proportions of 1, $2\frac{1}{2}$, 3, 5, 10, and 20 in weight of gold of uniform fineness ($\frac{900}{1000}$). The statute does not provide how much the several pieces enumerated shall be *worth*. But the weight and fineness of metal being established for each, they pass in the community and are "valued" by business men at \$2.50, \$3, \$5, \$10, or \$20, as the case may be. That is, a piece of gold which has 51.6 grains of gold is valued at just twice as much as a piece containing 25.8 grains. If, therefore, the latter is one dollar, the former would be valued at \$2. They all pass "at par" by virtue of this exact proportion of gold having the same quality and fineness, and thus the "three-dollar" gold piece will pass interchangeably for three "one-dollar" pieces.

*Gold coins of the United States.*

We also have in our system "silver dollars," "half-dollars," "quarters," "dimes," etc. The statute prescribes just how much silver there shall be in each, of $\frac{900}{1000}$ fine, and what stamp and impress shall be put on them. The law does not attempt to prescribe how much these coins shall be *worth*; it simply makes provision for their form, weight, and fineness. The Government also holds itself ready to exchange a silver "dollar" for a gold "dollar," and with this lets each man decide for himself how much it is worth.

*Silver coins of the United States.*

Minor coins are also a part of our metallic money equipment. The five-cent pieces, "nickels," and "cents" add to convenience in making exchange. "What is a 'nickel'?" or "What is a cent?" may be determined in the same manner as "What is a silver dollar?" They are pieces of metal, of definite form, weight, and quality, which the Government agrees

*Minor coins.*

to exchange for gold coins at the rate stamped on their faces.

*Paper money in circulation.*

Besides the gold, silver, nickel, and bronze metallic moneys there are nine classes of paper moneys in circulation, each of which has a definite provision for form and design. Paper money is issued in denominations of $1, $2, $5, $10, $20, and higher multiples. Each is in the nature of a promise of the Government, directly or indirectly, to deliver the number of dollars (gold) for which it is issued. The United States notes (greenbacks) are promises of the Government to pay to the holder a definite number of gold or silver dollars "on demand." For example, a "two-dollar greenback" is one which has written upon it the promise of the United States to pay to the bearer on demand two gold or silver dollars. Silver dollars, however, are exchangeable for gold whenever gold is desired. Therefore it is entirely optional with the holder as to which will be received.

1. *United States notes or greenbacks.*

2. *National bank-notes.*

A national bank-note is a promise of a national bank to pay to the holder, or bearer, on presentation, the amount named in the bill in legal-tender money of the United States—i. e., in gold, silver coins, or greenbacks. This makes the bank-note indirectly convertible into gold at the option of the one owning or holding it.

3. *Gold certificates.*

The Government, recognizing the inconvenience of carrying about a large fund of gold, has made provision for the deposit of gold funds in the Treasury, either as coin or bullion, in any amount in which they may be accumulated, against which an equal amount of gold certificates, or certificates of gold deposit, is issued. Thus one holding the certificates may, "on demand," have the gold "dollars" or the money value of bullion deposited.

The silver certificate is issued for a similar purpose.

Silver money is about sixteen times as heavy as gold money. To carry about a large fund of it becomes impossible; even small sums are very inconvenient to handle. By allowing a deposit to be made and certificates of deposit to circulate as money in their stead, the public is served in every manner the same as by the use of the coin. At the same time, if gold is preferred, they may be exchanged for gold when presented for payment.

*4. Silver certificates.*

Similar privileges were formerly given to owners of silver bullion. Instead of requiring the owner to have his metal coined before putting it into circulation, the Government allows him to deposit the bullion at the coinage value and receive certificates which entitle him to withdraw silver coin. Thus the Government has the metal for coinage if occasion requires, but is not put to the necessity of coining it. The certificate is indirectly exchangeable for gold "dollars" in the same manner as "silver certificates." The process is only one step farther removed.

*5. Treasury notes of 1890.*

The holders of small denominations of "greenbacks" find that it takes a long time to count out large sums with accuracy. As a means of avoiding this, small bills may be deposited to the amount of $10,000 or multiples thereof, and one or more bills or "currency certificates" may be issued to represent the amount deposited. Thus, for the transfer of $1,000,000 it would require only one hundred bills of the lowest denomination. These, as may readily be seen, are indirectly exchangeable for gold.

*6. Currency certificates.*

Fractional currency notes were issued for small change during the civil war when gold and silver were scarce. They were issued in fractions of a dollar, and were derisively called "shinplasters." They have been canceled as fast as presented at the Treasury, but there are still about $15,000,000 outstanding.

*7. Fractional currency notes.*

Old demand notes and compound interest notes are forms of currency similar in character to the greenback, except that the latter bears compound interest at the rate stated in the contract. They are in the nature of promises of the Government to pay on demand gold or silver in exchange.

*8. Old demand notes.*
*9. Compound interest notes.*

In none of these forms of money does the Government attempt to say how much it is worth. It simply determines what a "dollar" is—i. e., it represents that *a dollar is a coin of the United States containing 23.22 grains of fine gold* with one-tenth of alloy to prevent abrasion. It then agrees to exchange all forms of money, other than gold, for coins of that metal, and supplies itself with a reserve fund of gold to this end. The public is left to place its own value on the gold "dollar" as well as on all other coins and bills in the system. The process of redemption operates to make the estimates or valuations of all kinds of dollars alike. The value of a "dollar" of any kind is therefore the value of 23.22 grains of pure gold.

*The uniformity of value in our system.*

# CHAPTER III

## CREDIT FUNDS

Credit is a contract made between two parties whereby the one promises to deliver a certain amount of money to the other at a specified time. This contract, or promise, may be written or oral, formal or informal, expressed or implied, but in each case the essential fact is the same—a contract for the future delivery of money. A "credit transaction" is one in which a promise to pay (i. e., a contract for future delivery of money) is exchanged for something else of value. When one deals "on credit," he deals on his own promises to pay, or contracts for future delivery, instead of money; when one buys for (or on) credit, he purchases goods and gives his obligation to pay in exchange; when one sells for (or on) credit, he transfers his goods to another in exchange for the promises of that other to deliver a definite sum of money at a definite future time.

*Definition of credit.*

### Illustrations of Credit Uses

Morgan is a young man of sober, industrious habits, is well trained, and has a good reputation in the community where he lives. He decides to begin business for himself. He goes among the farmers with whom he is acquainted, and asks them if he may become their agent for the sale of grain in Chicago. A list of clients is scheduled which seems to warrant the opening of an office. But he has no capital, and it will require at least $1,000 in "funds" to equip and manage an office where he can display his sam-

ples, meet prospective buyers, manage consignments, etc. He lays his plan before his friend Drexel, who has an abundance of means and who makes it his business to supply funds to those who have need for them in business. Morgan explains his plan, shows his assured list of clients and his business prospects, and proposes to Mr. Drexel that if he will give to him $1,000, then he (Morgan) will execute to Drexel a contract in writing for the delivery of $1,100 one year hence. Mr. Drexel has confidence in the integrity of young Morgan, and after studying his plan of undertaking and his prospects of success, he decides to exchange $1,000 for Morgan's contract to deliver $1,100 one year hence. No money passes, however. Morgan hands to Drexel his "note" for $1,100, and Drexel gives to Morgan his "check" for $1,000. Morgan takes the check to the bank and presents it, and the cashier transfers $1,000 from the credit account of Drexel to the account of Morgan. That is his capital. This credit account is the "fund" with which his business is begun.

*Credit as current funds.*

Morgan now goes to Chicago, where he has the credit account transferred to a bank. He rents and equips an office. He forms business relations with an old and reliable produce broker who has a seat on the Board of Trade, and agrees to divide commissions with him until, finally, he is able to purchase a seat of his own. He devotes himself to building up and enlarging his clientage. By advertisement and constant effort he gains prestige; he arranges with the bank to carry the margins of speculating clients; he finds constantly increasing profits in his commissions. A business which at first netted him only enough to meet office and personal expenses, after years of effort nets him $10,000 per month. During this time he has paid the original loan from Drexel, bought a seat on the produce brokers' board (the Board of Trade), and at a mature age becomes possessed of many valuable properties and securities. All of this has come to

him from the use of credit, from untiring energy, from thrifty habits, and an unimpeached integrity. He now wishes to retire from the business of brokerage and to lead a more quiet life, devoting only such time to business affairs as may be necessary to the care of his investments.

Gates, a young man of wealth, and a friend of Morgan, desires to engage in the business of brokerage. He does not wish to spend a life of hard competitive effort in building up a new business; he prefers to buy a business already established. He goes to Morgan for advice, and each recognizing an opportunity, a bargain is made, whereby Gates agrees to pay $50,000 for Morgan's seat on the Board, and $250,000 for the business name of his firm. That is, Morgan retains all the securities, accounts, and investments acquired by him in course of business; he sells his seat (his opportunity to trade on the Board) and his "good will" (or business reputation) for the sum of $300,000. But how is this to be paid for? Does Gates count out standard gold coins to that amount? No. He does not even pass to Morgan his check. Finding that it will be advantageous to retain his present available "funds" for use in the business, it is arranged that the purchase shall be made "on credit"; that is to say, Gates offers to Morgan three promissory notes for $100,000 each, due in one, two, and three years respectively. The purchase price of the business is $300,000, as agreed, but in consideration of the time that payment is deferred, Gates further promises to pay 5 per cent interest on the respective amounts until they are paid. By these several contracts (agreements for the purpose of exchange) Gates promises to deliver $115,000 at the end of the first year, $110,000 at the end of the second year, and $105,000 at the end of the third year—$330,000 in all, principal and interest—instead of $300,000, the purchase price if payment had been made in money at the time the business was delivered. Now note just what has taken place. Morgan has sold what? Nothing tangi-

*A credit purchase.*

ble; nothing that may be seen; nothing that may be passed from hand to hand. He has disposed of his business opportunity and his business reputation as a broker—nothing else. Morgan may still do business in any other way so long as he does not attempt to use his seat on the Board or the name and reputation of his old firm for the business of brokerage. And what has he received? Something tangible? Something that may be seen? Something that may be passed from hand to hand? Yes, but what is it? Is it gold? Is it money? No. What is it? "*Paper.*" One slip reads as follows:

$100,000.00. NEW YORK, *January 1, 1901.*

One year after date, for value received, I promise to pay to Morgan or order One Hundred Thousand Dollars in gold coin of the United States, of present weight and fineness. With interest at the rate of 5 per cent per annum from date until paid.

[Signed] GATES.

The other two slips read exactly the same way, except as to date of payment. But suppose Morgan loses these slips of paper, or that they are destroyed by fire, is the credit destroyed? Not at all. The obligation to pay remains as before; if Morgan can prove the loss and likewise the amount due, he can enforce the payment. These slips of paper are only *evidence* of the credit agreement, which in itself is a thing as intangible and as invisible as that for which it was given—viz., business opportunity and business reputation. Still, credit is bought and sold in the market; in fact, credit is one of the chief items of exchange in mercantile business.

### ESSENTIAL CHARACTERISTICS OF CREDIT

Good-will, membership in a society of brokers, business opportunity and reputation are the properties that have changed hands. They have not been given away. None of them has been exchanged for another—they have not

been bartered, yet no money has passed. They have been bought and sold, full payment has been given and received, and the full title has passed. What represents the other side of the transaction? As a result of the exchange there came into being, and still exist, Gates's notes for $330,000. All these promises have purchasing power, and so long as they exist they may serve again and again in any number of transactions until paid, or until their values are lost by depreciation.

*Credit arises out of exchange.*

To understand the nature of credit it may be well to reflect on the underlying principles of exchange. In the first place, why did Morgan and Gates trade? Morgan had a business that was bringing him in a net profit of $10,000 per month—$120,000 per year. This was its net income-producing power to him. Much of the return was due to continued personal effort, but the reputation of the firm was so well established that its clientage in large measure would be retained, though its management were changed. Morgan, however, wished to avoid the nervous strain and the responsibilities of an active broker. In his judgment he would rather have $300,000 in gold than the business which he has sold—i. e., he estimated or valued $300,000 more highly than the business. Gates, on the other hand, would rather have the business than $300,000 in gold; each found the transaction to his advantage and $300,000 was agreed upon as the price. Here was a difference as to valuation but an agreement as to price, and the exchange took place as a result.

*The principles of exchange as applied to credit.*

Now after the price has been agreed upon there follows another transaction. Instead of Gates delivering the $300,000 in gold first agreed upon as the price, he offers to Morgan his three notes, each for $100,000, with interest—obligations for the future delivery of money, amounting in all to $330,000 when due. Morgan accepts these in lieu of the $300,000 in gold. Why does Gates offer the notes, and

why does Morgan accept them? Gates offers them because he values $300,000 in gold more highly than the notes. Morgan accepts the notes because in his judgment they are quite as valuable as $300,000 in gold. Morgan indorses the notes and sells them for $305,000. Why does the purchaser offer, and Morgan accept, that amount? Manifestly, because the purchaser thinks the notes of greater value to himself than $305,000, while Morgan esteems the $305,000 more highly. The purchaser of the notes is an investor in commercial paper; he gets his income from furnishing current funds to those who wish to sell credit on terms of advantage to him. Morgan is also about to devote his energies to investment, but his judgment is that he will profit something by exchanging the notes for $305,000 in gold. But again, the purchaser of the notes, instead of paying Morgan $305,000 in gold, hands to him his check for that amount, which is accepted. It is quite clear that this was done because the one making the purchase thought it to his advantage, while Morgan valued the check quite as highly for the purpose of exchange as he did the gold.

*Value and price of credit.*

We now pass to the consideration of the basis of credit—i. e., the elements in it which cause credit funds to be valued more highly than money and consequently to supplant money exchange. Morgan's judgment is that the promise of Gates to pay $300,000 with interest at 5 per cent is more desirable than his own business as a broker. But why? Before an exchange can take place the conclusion must be reached; but by what process? The thing to be considered is a contract for future delivery of money. The promise is that Gates will pay $330,000 in gold at a definitely appointed time. In estimating the value of such promises, what element must be taken into account? In the first place, Morgan must estimate the ability of Gates to obtain that amount of gold at the time proposed.

*Basis of the credit judgment.*

1. *Ability to obtain money for future delivery.*

He sells his business; he receives a claim against the future income of Gates; he must, in estimating the ability of Gates, therefore, consider his facilities for obtaining money. But this is not all. There is a second consideration. Morgan must not only pass judgment on Gates's ability, but he must also take into account Gates's disposition to apply the money obtained to the fulfilment of his promise—to the payment of the claim when due. These two judgments lie at the basis of all credit; on these two elements does the value of credit rest. (1) A judgment that the one promising is able to fulfil his promise. (2) A judgment that he will be *willing*. Willingness is another name for "honesty" or "integrity." If these two judgments are favorable, or, as the business man would put it, if Morgan has "confidence" in the *future* delivery, he is in a position to make a business estimate as to the *present* value of a *future* income of $330,000. Confidence is nothing more or less than the result of judgment that a person is both *able* and *willing* to do what he promises.

*2. Business integrity.*

*The result of a favorable judgment—Confidence.*

That which we call security is a *contract* whereby a favorable judgment is secured when otherwise such judgment would be lacking. In the transaction in which Morgan sells Gates's notes, the purchaser of the notes was not well acquainted with Gates, and was not in a position to pass favorable judgment; he did not value Gates's ability and integrity as highly as did Morgan. The purchaser of the notes, perhaps, would not offer more than $250,000 for them, but he knew Morgan and had *confidence* that he would meet his credit obligations. He was willing to buy Morgan's contract for future delivery of $330,000, at the times specified in the notes from Gates to Morgan, for $305,000. He therefore proposes that he will pay $305,000 for the notes, on condition that they be indorsed by Morgan. What was the force of this indorsement? Why did the simple fact of Morgan's name written across the backs

*Security.*

of the notes raise the purchaser's valuation to such an extent that he was willing to add $55,000 to his offer? By operation of commercial usage (law) the addition of Morgan's name set up a new *contract*. If this contract had been written out in full it would have been as follows:

In case Gates does not pay this note when due, upon notice given to me, I hereby promise to pay it in full myself.

[Signed] MORGAN.

This contract is one of the obligations known as *personal security*. Now the purchaser has *confidence* that the several amounts promised by Gates will be paid at the time specified, and he offers Morgan $305,000 for them. The effect of security is to obtain a more favorable estimate as to the value of the contracts for the future delivery of money which Morgan offered for sale; it increased the price obtainable from the credit and decreased the cost of the money or other things received by Morgan in exchange for credit.

*Relation of security to credit.*

### CREDIT VIEWED AS A "SHORT SALE" OF MONEY

No better illustration of a credit transaction may be found than what is known as a "short sale"—the sale of something that one does not possess. Pillsbury & Co. are millers. They enter into a contract for the delivery of 10,000 barrels of *A* flour to Kimball & Co., of Liverpool, at any time that Kimball & Co. may want it, after May 1, at $8 per barrel. Their business manager has made a sale of something that they do not possess—something that they are "short" of. They have neither wheat nor flour. The company has only a mill and other equipment for making the kind of flour sold. The contract for future delivery, however, is important to the successful management of the mill. By this, one factor in the manager's problem is solved—the price

*A short sale of flour.*

which he will receive for his output. From business experience he is able to calculate another factor with substantial accuracy, viz., the cost of manufacture. If, therefore, the manager can make a contract which will fix the cost of the wheat to be used in the manufacture of the flour, he can calculate the profits as well as if he had sold flour already produced.

*A short sale of wheat.*

Wheat was selling at 99 cents per bushel at the time that the "short sale" of flour was made. If, the company's manager calculates, "No. 2 Hard Spring" wheat may be had at $1 per bushel, his company will make a profit of $2 per barrel on the Liverpool contract. To assure his company of this, he enters into another contract with Brown & Schaffer, produce-brokers, for the future delivery of 50,000 bushels "No. 2 Hard Spring" wheat "on call" after thirty days, at $1 per bushel. But Brown & Schaffer have no wheat at the time the sale is made. They are "short" of the commodity contracted for, but, being a reliable business concern, Pillsbury & Co. make a part payment, or "put up a margin," and rely on Brown & Schaffer for the delivery of the grain. The manager can now devote himself to the manufacture of flour without being troubled about fluctuations in the price of wheat; he has shifted the risk of market fluctuations in the price of wheat to Brown & Schaffer. Pillsbury & Co. have made a "short sale" of flour, and to cover the risk of fluctuating price they enter into a contract for the future delivery of wheat.

*Settlement of the short sale of wheat.*

Brown & Schaffer sold "short" of "No. 2 Hard Spring" wheat at $1 per bushel for delivery on demand after thirty days. They did this because in their judgment wheat was "going down"; they wished to buy on a better market to fulfil their engagement with Pillsbury & Co. Instead of going down, however, a "corner" is formed in this grade of wheat and the price advances rapidly. Thirty days hence Pillsbury

& Co. "call" for the delivery of 25,000 bushels. Nothing will satisfy the contract under which the call is made but "No. 2 Hard Spring"; this is the grade needed for the milling process for the production of the kind of flour sold to Kimball & Co.; this is the only kind that will be received. Whatever the sacrifice to be made by Brown & Schaffer, there is for them no alternative other than to deliver the exact thing promised, or to "settle"—i. e., to turn over to Pillsbury & Co. $12,500, to pay the difference between the contract price and the market price, which on that day happens to be $1.50 per bushel. In other words, before Pillsbury & Co. will agree to "settle," Brown & Schaffer must place the mill company in a position to buy $1.50 wheat at a cost, to them, of only $1.

The Pillsbury company, however, have not the extra $25,000 with which to pay for the wheat needed. The manager therefore takes the $12,500 received from Brown & Schaffer and goes to Armour & Co., whose elevator bins are filled with "No. 2 Hard Spring," which they are holding at $1.50 per bushel; he arranges to purchase 25,000 bushels at $1.50, paying down $12,500 (the amount received from Brown & Schaffer), giving his firm's note for $25,000 (principal) and $500 (interest), due in ninety days in payment for the balance. The wheat is immediately delivered. Pillsbury & Co. have purchased 25,000 bushels of the kind of wheat desired. They have become the absolute owners of it; they may grind it and dispose of it as they please. But how has the wheat been paid for? In exchange, the company, in part consideration, has sold its contract for the delivery of $25,000 "on call" after ninety days; it has made a "short sale" of money—has again promised to deliver something that it was "short" of at the time the contract was made, hoping to obtain the money from Kimball & Co., of Liverpool, in return for the flour, before the maturity of the note. Thus, the calculation is, the return

*A short sale of money.*

on the contract for the short sale of flour will cancel the contract for the short sale of money, and the Pillsbury company will have the difference between the two contracts as profit.

The same rules, identically, apply to the credit contract of short sale of money as applied to the short sales of flour and of wheat. Nothing will satisfy the credit contract but the delivery of the thing promised. Pillsbury's manager makes a similar contract on the purchase of the remaining 25,000 bushels of wheat due from Brown & Schaffer; he grinds his flour and delivers it to the Liverpool merchants in time to meet the short sale of flour to them. But Kimball & Co. fail to make return in money on the shipment; after the delivery of the flour Kimball & Co. become bankrupt. Nevertheless Pillsbury & Co. must meet their "short sale" of money—their two notes for $25,000 each to Armour & Co. on demand after ninety days. This must be done even though it requires the sacrifice of working capital, credit accounts, treasury securities, even the milling plant and business reputation of the company. All must be sold, if need be, to procure the money for delivery under the contracts to Armour. Nothing but money will satisfy the contracts. If the notes be for the delivery of "gold coin of the United States, of present weight and fineness," then gold coin of this description must be delivered, or a "settlement" made—a new contract entered into for the delivery of something else which Armour & Co. will take *in lieu* of gold. Greenbacks may be offered instead, and accepted; Pillsbury's check may be taken as readily, if Armour believes he can get the amount of gold contracted for in exchange for the check. If Pillsbury & Co. can not get greenbacks, or if they have not a bank account, then they may offer to Armour some real estate in St. Paul, and this may be taken "in settlement" of the short sale. On the other hand, unless something else will be taken "in settlement" by Ar-

*Rules of settlement the same as in case of short sale of wheat.*

mour & Co., there is no alternative. Pillsbury must get the gold or be declared bankrupt.

In a period of great financial distress—in other words, at a time when demands for delivery of *money* on credit contracts are large—the price of money may be *forced up*; all kinds of property may command a low price in exchange for money. As in case of the corner on wheat, those who have sold "short" of money may have to pay any price necessary to obtain the thing contracted for, or for such other "funds" as will be received in place of money by way of "settlement." When demand is made for payment, money may cost two or three times as much as at the time the contract for future delivery is entered into. Failure to meet these contracts means bankruptcy—the sacrifice of all forms of property on the altar of "short sales" in credit. Bankruptcy is, in effect, a means of judicial "settlement" of short sales of money in cases where the parties to the contract can not come to a new agreement or "settlement" among themselves.

*A corner on money—Financial distress.*

## Financial Uses of Credit

In its relation to finance, credit has two uses: (1) It may be used as a means of obtaining funds. (2) It may itself be used as "funds." The second use is the subject of present consideration. Very often it happens that a merchant will take his note to the bank for discount. In this case the transaction is one of exchanging a form of credit created for the purpose of obtaining "funds" (a note) for another form of credit which is created for the purpose of being used as "funds" (a bank account).

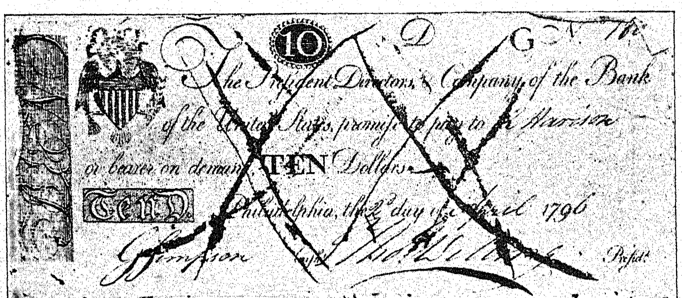
## Forms of Credit used as "Funds"—Bank Credit

Bank credit is a form of contract for the future delivery of money, especially created to serve the business commu-

nity as "current funds." The capital of the bank is in the form of a "money fund." This stock of money is held in reserve—is used to support its credit. The whole equipment of a bank is directed toward this end, and its success or failure depends on maintaining its credit currency. The obligation of the bank is to pay money on demand. It must always keep in stock a "money fund" sufficient to meet the demands of creditors for delivery of money under these contracts. The larger its money fund the greater the amount of credit currency it can safely sell to its customers. About 50 per cent of the funds of a well-organized business community are in the form of bank credit; about 90 per cent of the exchanges of such a community are made for bank credit in one form or another.

*Bank-notes.*

There are several forms of contracts for the delivery of money which are sold by a bank for use in a community as funds. One of the most common is the "bank-note." The bank-note is a written promise of the bank to deliver or "pay" the amount of money named on its face to the one presenting it at its counter. The following is a photo-copy of a ten-dollar-note issued by the first Bank of the United States in 1796. This form of note is known as a "Willing Note," taking its name from




Mr. Thomas Willing, the president of the bank. The second reproduction is known as a "Biddle Note." It was issued

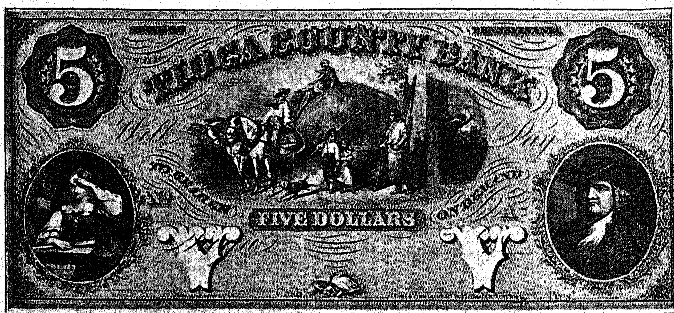
by the second Bank of the United States in 1829. In most countries bank-notes may be issued only in conformity with


certain legal regulations and under such guarantees of government as to cause them to pass from hand to hand as "money." Until about the middle of the last century this was the most usual form of "bank credit" used by business men. In exchange for notes, bills, accounts, etc., offered to the bank for sale by customers, it would give


out its own notes. At the present time, however, the most common form of bank credit is the bank-account—a credit fund represented on the books against which the person owning it may draw checks in any amount desired. The "notes" of the bank are purchased by its customers, because they may be passed from hand to hand in the community as current funds. They are considered as good as

money because the community believes the bank issuing them to be so conducted that it can at all times deliver the money contracted for if demand be made, and, being more


convenient to carry about than gold and silver, the notes are preferred. The bank-account adds to this convenience that of allowing the business man to draw for the exact amount needed. In the early half of the last century there were many abuses of public confidence on the part of banks. Each State had its own peculiar laws, and many projects were devised which flooded the country with bank-notes that proved worthless. This caused the Federal Government to pass stringent laws regulating issues and deposits. In the United States, at present, "national banks" alone issue notes. These notes are also called "circulation."



*Bank-accounts—Deposits.*

A bank-credit "account," sometimes called a deposit, is in reality not a deposit in any sense of the word. The customer of the bank takes to it money and "checks" (or other promises and orders to pay money) which are owned by him and sells them; he exchanges these for an "open account" at the bank. The customer desires a credit at the bank because it will serve him better than any other form of current funds. The exchange takes place by reason of the fact that each gains a business advantage by so doing. The bank can use the money and checks purchased ("deposited") to greater advantage than can the customer, while the customer can use the current credit of the bank to better purpose in his business than can the bank itself.

*Emergency currency.*

It sometimes happens that the banks are reduced to a condition in which their money reserves are threatened, and with this their contracts for delivery of money—i. e., their outstanding credit. Various temporary expedients are at such times resorted to, such as the creation of credit instruments that will be received in "settlement" in lieu of money, but which are not contracts for the immediate payment (or delivery) of money over the counters. For example, during the financial crisis of 1893 the Marine Bank of Buffalo issued to its employees a form of certified check for payment of wages and salaries; instead of giving them money in payment of credit accounts, they issued a new contract for future delivery of money, which the owner or borrower could pass in the community, in settlement of his own credit obligations, until the bank should be able to take up these checks without impairing its reserve. Likewise, the South Chattanooga Savings-Bank, not having money to deliver, on demand, to those wishing to withdraw, in August of that year issued a new contract for the delivery of "current funds" four months hence, a copy of which is given on page 46. This form of currency temporarily answered as funds to

those receiving it, and the certificates were taken in "settlement" of the contract of the bank entered into at the time

THIS IS TO CERTIFY, THAT THERE HAS BEEN DEPOSITED IN THIS BANK FIVE DOLLARS, PAYABLE TO THE BEARER OF THIS CERTIFICATE, IN CURRENT FUNDS FOUR MONTHS FROM DATE.

CHATTANOOGA, TENN. AUG. 19, 1893. SOUTH CHATTANOOGA SAVINGS BANK.

BY..........................................

THIS CERTIFICATE WILL BE RECEIVED ON DEPOSIT **5** OF ANY DEBT OR OBLIGATION TO THE

FIRST NATIONAL BANK, CITIZENS BANK & TRUST CO.,
THIRD NATIONAL BANK, WIEHL, PROBASCO & CO.,
CHATTANOOGA NATIONAL BANK CHATTANOOGA SAVINGS BANK,
SOUTH CHATTANOOGA SAVINGS BANK.

THIS CERTIFICATE IS SECURED BY THE DEPOSIT OF APPROVED SECURITIES IN THE HANDS OF T. G. MONTAGUE, PRESIDENT FIRST NATIONAL BANK, AS CUSTODIAN TO DOUBLE THE AMOUNT ALL SUCH CERTIFICATES.

..........................................
MANAGER,
CHATTANOOGA CLEARING HOUSE ASSOCIATION.

the deposit was made. During the financial strain or "panic" in 1893, the enforcement of contracts for delivery of money would have caused the banks of New York to sacrifice their entire assets to obtain the gold or other forms of "current funds." They had sold to their customers "demand cred-

Twenty Thousand Dollars.

*No.* 0000 $20,000.

**Loan Committee of the New York Clearing House Association.**

*New York,* ____________ *1893.*

***This Certifies,*** *that the* ____________
*has deposited with this Committee, securities in accordance with the proceedings of a Meeting of the Association, held June 15th, 1893, upon which this Certificate is issued. This Certificate will be received in payment of balances at the Clearing House for the sum of* TWENTY THOUSAND DOLLARS, *from any Member of the Clearing House Association.*

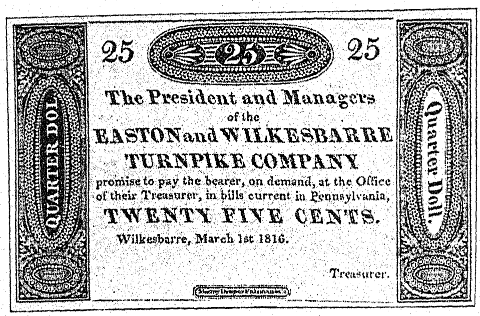
On the surrender of this Certificate by the depositing Bank above named, the Committee will endorse the amount as a payment on the obligation of said Bank, held by them, and surrender a proportionate share of the collateral securities held therefor.

**$20,000.**

Committee.

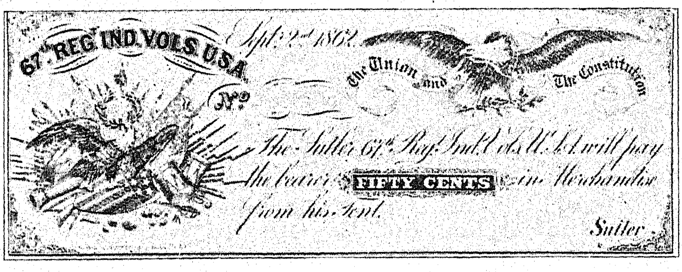
its," "short-time" current funds with which to meet them. To tide over this emergency, clearing-house certificates were agreed upon, to be taken in settlement between each of the clearing-house banks. Since they could use certificates of indebtedness of the Clearing-House, collaterally secured by

assets of the bank, this form of credit funds avoided the necessity of selling the assets to obtain gold for payment.



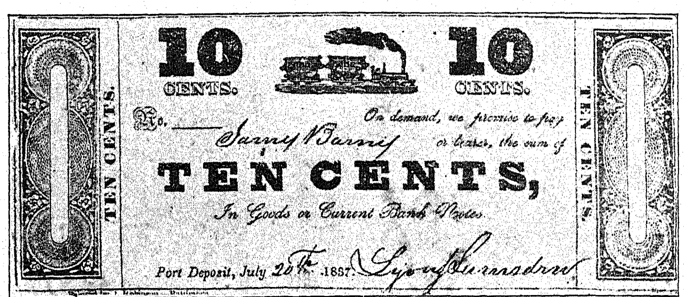

Merchants and manufacturers may resort to the same kind of expedients during periods of financial stress as that above described with reference to issues by banks. They may "settle" their wages-accounts by means of "scrip," as it is called—i. e., pay a credit contract which is due with another contract for delivery of money or goods at a definite future time; and the various merchants or business men of the community, believing that the one issuing the "scrip" will be able

*Emergency funds—Commercial.*




to meet it after the financial strain is past, are willing to take it in payment for goods and the scrip passes current. Every period of financial strain or business depression since the Revolutionary War had its scrip issues. After

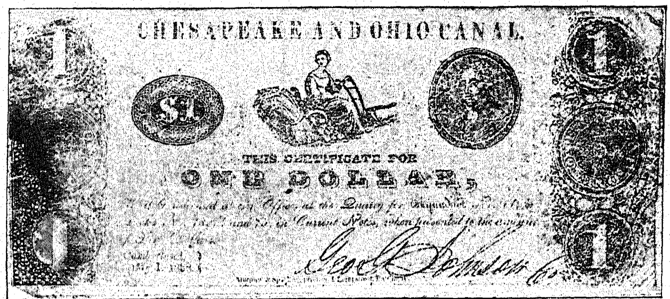
the War of 1812 there was great financial distress, during which time the country was virtually without metallic cur-



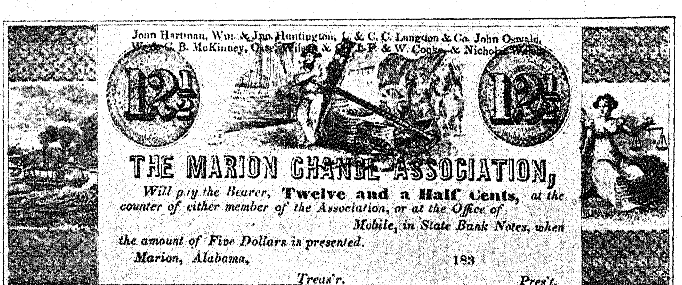

rency. To meet this emergency business houses and concerns of every kind issued "shinplasters," as they were called. The first here exhibited is from an issue of the Old Easton & Wilkes Barre Turnpike Company. From 1837–'41 the issues of private concerns were almost the only currency in use. The scrip of the Camden & Woodbury


Transportation Company and that of the Chesapeake & Ohio Canal Company are good illustrations of the form of funds in current use by transportation concerns of the time. The demand for "change" at this time finds illustration in the issues of the Marion Change Association of Marion, Ala. Being without money or means of carrying on transactions with their customers, the leading business men

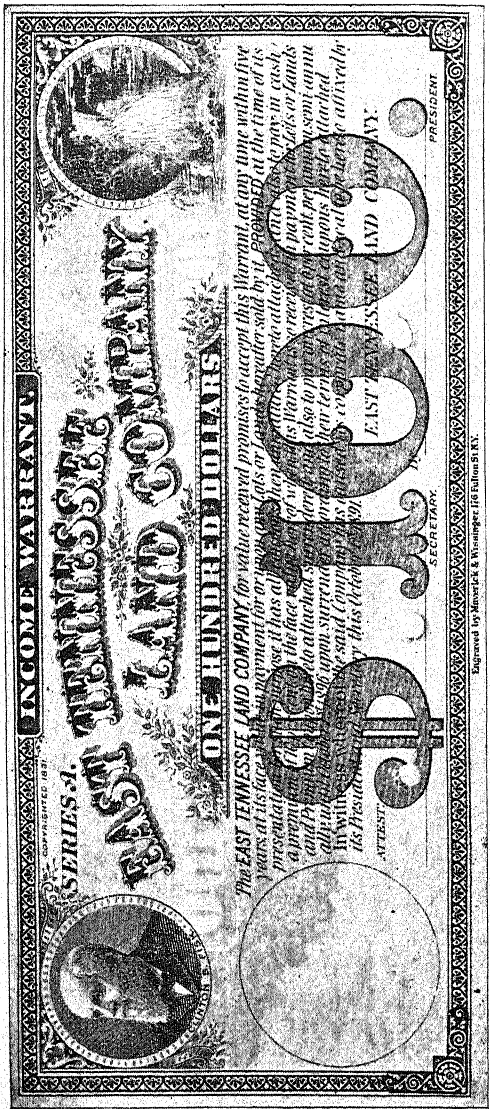
of the place, whose names appear at the top of the bill, organized for mutual accommodation. Certificates of de-




posits of savings-banks were also put into use as money in denominations to suit the convenience of customers. An-




other form of currency is what is known as a dividend warrant. It is intended to serve as funds without putting the




concern to the necessity of raising funds to pay dividends. Generally speaking, it is a dangerous expedient, and indicates financial weakness in the company using it. The dividend warrant is sometimes used as a means of making sales of property which a company may have on the market. The dividend or income warrant here exhibited is of this sort.

*Public emergency currency.*

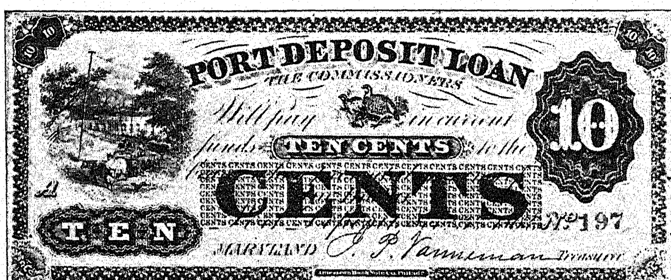
Various departments of the Government may at times find themselves under temporary financial disability — may not be able to meet outstanding credit demands or procure funds for necessary pur-

chases. Instead of making the sacrifices necessary to procure gold or other current funds demanded, new contracts for the future delivery of money may be sold or exchanged for old ones already matured. A copy of a certificate of indebtedness or obligation of the town of Fayetteville, Ark., as issued in 1842, is here exhibited. Nearly all the States


and local divisions of States were at that time bankrupt from having undertaken public improvements in the form of canals, railroads, and turnpikes. These notes were paid out to officers and others having credit claims against the towns, and were circulated in the community in the same way as are national bank-notes to-day. The scrip of the town of Port Deposit issued during the depression of 1857, and that issued by the same town in 1862, when the levies of war had depleted local funds, are good examples of the emergency currency issued by towns at a later time. After the catastrophe at Johnstown, Pa., a similar financial method was resorted to. Bond certificates in convenient denominations, to the amount of $20,000, were put into circulation as a means of meeting current necessity. In 1893 the city of Richmond issued a 6-per-cent bond certificate of similar character. The "warrants" of counties and school districts find like employment. The one- and two-year "interest notes" issued by the National Government during the civil war were "emergency currency" for the use of the Federal Government. They were contracts for the delivery

of money one or two years from date given, in settlement for credit claims due, and on which demand for payment


had been made. The United States note or "greenback" was originally a species of emergency currency in the nature of a contract for the delivery of gold or silver coin "on demand." It was understood, however, at the time of issue, that the demand would not be met until the Government had the necessary gold and silver in the Treasury with which to meet it. The result was that the notes did not pass "at




par" with gold or silver, but were received at a discount proportionate to the estimates of value based upon them by those receiving these promises.

### Commercial Credit Funds

Commercial credit or contracts for the future delivery of money are frequently given and received in transactions

with merchants, as between those using them they answer every purpose as "funds." The practise allows merchants to make sales and customers to make purchases. Under such credit arrangements a customer may order goods of a house "on credit" and make "settlement" for the credit at a future time. The promise to pay is unwritten; it may be made by tacit understanding. Some memorandum of the transaction is usually taken at the time, although it may be left entirely to the memory of the parties without any form of entry. A large part of the mercantile business of the country is conducted in this way. When one opens an account at a store he may make definite arrangements to have all purchases "charged"—that is, entered on the books—statements to be made and settled on the first of each month. When the customer is well known, however, and his ability to pay is undoubted by the merchant, he may order goods without any previous arrangement. In this case it will be tacitly understood that the purchaser of goods will pay the account when demand is made. One may go to a grocer and say, "Please send out a barrel of No. 2 Pearl flour." The merchant will deliver the flour and charge the price to purchaser's account on his books. The contract for payment is just as well understood as if a definite formal arrangement had been made. A manufacturer usually has many such arrangements with laborers, material men, and business houses with which he deals. So a retail merchant will deal on similar funding arrangements with wholesalers, and wholesalers with producers. This form of credit is not transferable except by special agreement, and can not pass current in the community. It answers as funds only to the one with whom the contract for future delivery is made.

In all lines of mercantile business "the books" will show a large number of current credits—that is, the regular customers will have an understanding that all orders will be honored to a certain amount, settlements to be made at

stated intervals. The goods purchased in this way become the property of purchasers as absolutely as if money had been paid for them. Goods are exchanged for credit on open account. The merchant has a right to enforce the collection of the claim in the same manner as if a promissory note had been given.

*Current credits.*

It often happens that two merchants, or a manufacturer and a merchant, may each wish to run an account with the other. In this case each will make entry of goods purchased, and at the end of the month or year settlement will be made by exchange of statements of account and the payment of the balance due.

*Mutual credit.*

# CHAPTER IV

## INSTRUMENTS OF TRANSFER OF CREDIT FUNDS

Every purchase and sale involves an exchange in possession and ownership. Money funds when used in exchange are passed from hand to hand. Many forms of credit funds, however, do not admit this method of transfer. For the purpose of making transfer of credit funds, several classes of instruments have come into vogue, each adapted to some special use or to the transfer of some special form of credit funds.

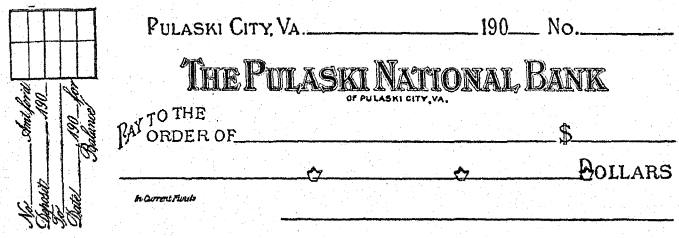
The most common form of instrument used for the transfer of credit funds is the "customer's check." A $10,000 credit account is purchased at a bank by a customer for the purpose of making current purchases and payments. He then buys a stock of goods for $1,000. In exchange for the goods the customer of the bank transfers $1,000 of his credit account to the one from whom the goods were purchased. To do this he draws his check for the amount.

*The customer's check.*

A "customer's check" is a sight draft on a bank for the payment of the amount of money stated therein, to a third person, "on account" of the maker. It differs from ordinary commercial drafts in that it is drawn against an account purchased of a banker for the very purpose of drawing against it; the bank is therefore bound to honor the check when presented. The check need not be in any prescribed form; it may be written on a blank sheet of paper, with a

*Form and significance of a "customer's check."*

pencil or entered on the printed forms of a bank. It is for the sake of convenience and uniformity that banks provide blank checks for the customers. These blanks are usually bound and given out to the regular customers of the bank in book form. Each check usually has a "stub," or short end, which is left in this book after the


No. ___ Amt. for'd ___ Deposit ___ For ___ 190__ Date ___ 190__ Balance ___

PULASKI CITY, VA. ______________ 190__ No. ________

THE PULASKI NATIONAL BANK

OF PULASKI CITY, VA.

PAY TO THE ORDER OF ______________________ $________

______________________________________ DOLLARS

In Current Funds

check itself has been torn out, on which memoranda may be entered for the convenience of the customer—it assists him in keeping a record of the transfers made by him, and of the amount of such credit fund still remaining at the bank against which checks may be drawn.

As before stated, no particular form is necessary, and a lead-pencil will serve as well as ink. The *bona-fide* intention of the one owning the fund or account is all that it is necessary for the bank to know. But certain rules should be followed as a matter of convenience to the bank and precaution to the drawer. In writing and signing checks good black ink should be used.

*How to make out a "customer's check."*

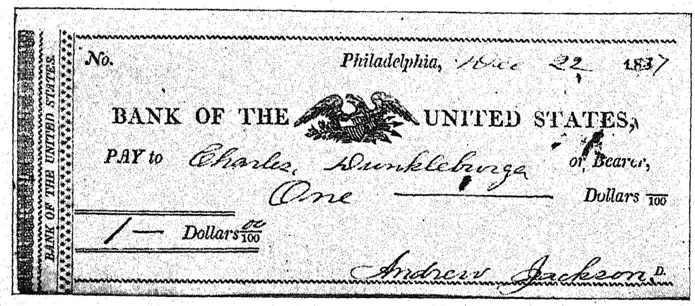
Checks should be dated, but the absence of the date does not warrant a bank refusing to cash them. While a note executed on Sunday is not good in many jurisdictions, a check so dated is valid. A post-dated check does not make the bank liable for payment if presented before the date entered. Checks should never be issued under an arrangement with the holders that they will not present them till a subsequent

*Date of check.*

date, inserted on the face of the instrument, as such practise often leads to complications of business relations which wreck the credit of the maker and put the bank to endless trouble.

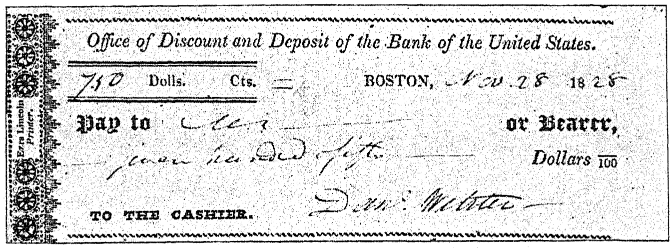
*Filling in the amount.*

A check may be drawn for any amount, so long as it does not exceed the "credit fund" of the one drawing. In the office of the Pacific Mills, Boston, may be seen the canceled check of the United States for *one cent*; on the walls of the Bank of Commerce, New York, is a check for $14,000,000, signed by the banking-house of Kidder, Peabody & Co. In this appears one of the great economies of the use of bank credit. It is just as easy to transfer $14,000,000 in form of credit funds at the bank as it is to transfer one cent. In writing in the amount, the drawer should begin at the extreme left of the line. The illustration here given is a copy of a check drawn by Andrew Jackson on the second Bank of the United States, for one dollar. It is an excellent example of a poorly written check, and one which could be very easily




"raised." One receiving such a check might write "one hundred" before the word "one," and "10" before the figure "1," and in this way raise the check from $1 to $101. If this were done, and the bank cashed the check, the bank would not be responsible for the loss. The *drawer* would be held responsible for his own carelessness. This

method of raising checks is the one most common in banking experience. It is wise to begin the writing at the left-hand margin, or draw a running line ~~~~~~~~ before as well as after the written words, thus preventing any additional writing. The check here exhibited, drawn by Daniel Webster on the Boston branch of the Bank of the United States, is a carefully drawn instrument. When




checks in which the figures in the margin do not correspond with the amounts stated in the body of the checks are presented to banks for payment, the courts have decided that the amount stated in writing shall be considered correct. The usual practise, however, is for the paying teller to withhold payment until he may satisfy himself as to the intention of the maker of the check.

It is not necessary to enter the name of the one to whom the credit funds are to be transferred. If a check is drawn "Pay to Bearer," any person that is the bearer can collect it and no name need be inserted. The name of a definite payee may be inserted, as, for example, "Pay to Leonidas Smith." Usually, however, checks are drawn to some person "or order." The phrase "Pay to the *order* of Leonidas Smith" signifies that the amount is to be transferred or delivered to Leonidas Smith, or to any person to whom he *orders* it paid.

*Entering the name of the payee.*

It is customary to number checks consecutively in the check-book so that each one can be accounted for. The numbers are inserted for the convenience of the custom-

er, and not for the convenience of the bank. The checks (or "vouchers," as they are called after they have been paid) when returned may thus easily be compared with the "stubs" of the check-book, or pasted back into the book and filed for easy reference.

*Checks should be numbered.*

A check-book is a bound collection of blank orders for the transfer of bank credit. The advantage of binding is that the "stubs" may be kept for reference. By reference to the memoranda so kept the customer may at any time know what amount of funds remain subject to draft. The "bank-book" or transcript of deposits shows the other side of the customer's accounts. At the end of each month this is left at the bank that the amounts drawn may be entered and a balance struck. If the bookkeeper's balance is different from the customer's, this may be accounted for by checks drawn but not presented for payment. There being no mistake, the bookkeeper's balance, less checks outstanding, will equal the balance appearing on the stubs of the check-book. The unpaid checks may be presented at any time; therefore the available balance of account is the amount shown by the "check-book." After the "bank-book" has been balanced, the paid checks are returned as "vouchers."

*The "check-book."*

If one wishes to draw money on his own account the check should be written "Pay to the order of *Cash*." This is preferable to a check drawn to "Bearer." A check drawn to "Cash" will not be paid to any one but the drawer or his well-known representative, while a check payable to bearer, if lost, might be misused. A check written "Pay to the order of . . . . [your own name] . . . ," will necessitate an indorsement—i. e., one drawing to himself would be required to indorse his own check before he could get it cashed.

*Drawing check to oneself.*

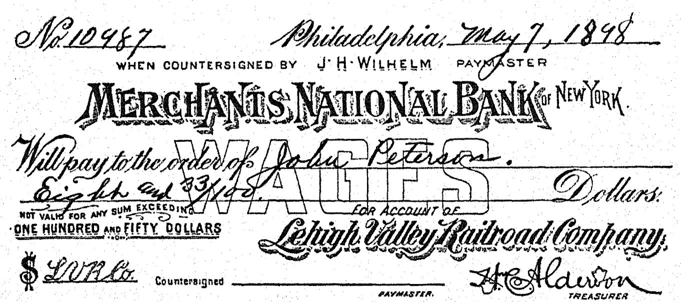
One wishing to draw a check to pay a note may make it payable "To the order of *Bills Payable*." One buying

a draft may indicate this in proper language, as "Pay to the order of *N. Y. Draft and Exchange.*" Any special personal use may be indicated on the face of the instrument.

*Checks drawn to oneself for special purposes.*

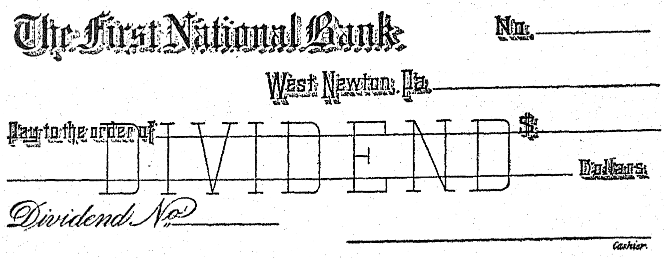
Likewise, a check drawn to another may have the purpose or use of the funds transferred indicated on its face; as, for example, "Pay to the order of John Jones, for September rent." When the check has been returned, indorsed by John Jones and paid by the bank, it will answer the double purpose of "voucher" from the bank and of receipt of payment of "September rent." A settlement of wages may be made by check, marked "Pay Roll" or "Wages." When objection is made to this, it is best

*Checks drawn to others for special purposes.*


No. 10487 Philadelphia, May 7, 1898
WHEN COUNTERSIGNED BY J. H. WILHELM PAYMASTER
MERCHANTS NATIONAL BANK OF NEW YORK.
Will pay to the order of John Peterson.
Eight and 33/100 Dollars.
WAGES
NOT VALID FOR ANY SUM EXCEEDING ONE HUNDRED AND FIFTY DOLLARS
FOR ACCOUNT OF Lehigh Valley Railroad Company.
$ L.V.R.Co. Countersigned ______ PAYMASTER. TREASURER

always to conform to the wishes of the bank—it is an unnecessary encumbrance of the paper which is intended to represent relations between customer and bank only. The transactions between Jones and the bank's customer may be represented in some other way. A bank will make no objection to the matter on the face of a check if it is printed or engraved, and has not to be written or inserted at the time it is drawn. The above form states the object for which the transfer is made. The large corporations of to-day have checks especially printed for nearly every account against which drafts are made. Other forms, quite as unobjectionable and more

simple in style, have the purposes of their issue printed in red ink across the face, or engraved in some form.


The First National Bank No. ______

West Newton, Pa. ______

Pay to the order of DIVIDEND $ ______

______ Dollars

Dividend No. ______

______ Cashier.

Many safety devices have been used to prevent the fraudulent alteration of checks. A customer may have an engraved check-form of his own, and will notify his bank that it may honor those only which are drawn on this prescribed form. But even then the prescribed blanks may get into the hands of those who would use them for purposes of fraud. As a means of preventing alteration and forgery, the amount may be punched or cut out of the paper. This safety device has been circumvented by having the holes filled with paper pulp and new figures cut or punched to suit the purposes of swindlers. Some companies have their checks limited on

*Safety devices in checks.*


No. ______ Lewisburg, Pa. ______ 189

H. Eyer Spyker

COAL SHIPPER

Pay to the order of ______ Dollars

To Union National Bank

Lewisburg, Pa.

$ ______

their faces. The best device yet adopted, however, to prevent "raising" is that employed by the express companies and the Post-Office Department. These will be explained later.

A novel instrument, used by the banks to save their customers the expense of paying the stamp tax imposed by the Government to help defray the cost of the Spanish-American War, is given below. It is in form a receipt for funds transferred or withdrawn. The internal revenue law provided for a minimum tax of two cents on each check. Instead of presenting a check, the customer would sign a receipt, and the bank would thereupon make the payments or deliver the funds for which the

*Receipts used as checks.*

Boston, Mass. Jan 29 1902

Received from

The Keystone National Bank, of Boston, Mass.

Twelve Hundred Sixty Five and no/100 —— Dollars

on account

$1265.00 Theodore M. Beardslee

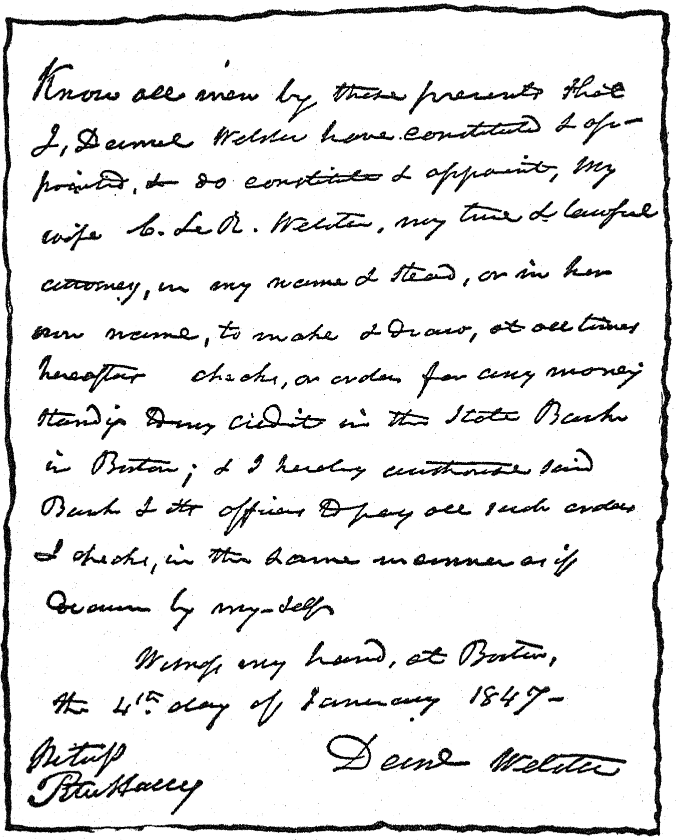
receipt was drawn. This was in general use in many parts of the country for direct dealings of customers with banks.

It is sometimes a convenience in business to give to some one else the power to check against one's bank-account. This may be done by giving to another a *power of attorney*—i. e., the right or authority to be your attorney, to represent you in the transfer of funds on your account at a bank. Authority of this kind must be in writing, unless the bank is willing to take the responsibility for oral authorization. Financial houses, as well as the United States Post-Office, issue printed blanks for use by those who wish to give to others the power to draw on their accounts or to sign money-orders. A power of attorney from Daniel Webster to Mrs. Webster, giving her authority to draw and sign checks, is represented opposite. This was first reproduced in Rhodes's Journal of Banking; it was taken from the files of the bank where it was used by Mrs. Webster.

*How to authorize others to draw on one's account.*

The "crossed check" is a form of customer's check not commonly found in America. In England, however, it is in common use. It is an ordinary customer's check that has across its face bars which signify that it must be presented for payment through some other banker. Such a check will not be cashed if presented by the payee himself to the bank against which

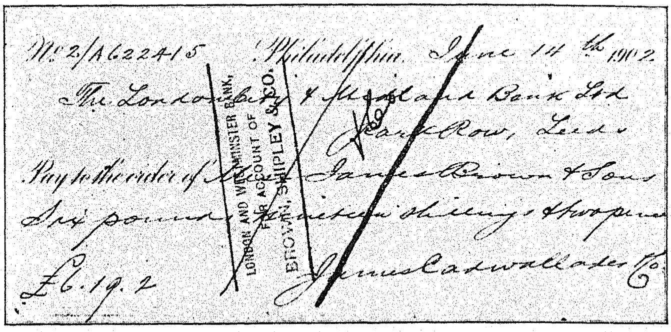
*The crossed check.*



Know all men by these presents that
I, Daniel Webster have constituted & ap-
pointed, & do constitute & appoint, my
wife C. Le R. Webster, my true & lawful
attorney, in my name & stead, or in her
own name, to make & draw, at all times
hereafter checks, or orders for any money
standing to my credit in the State Bank
in Boston; & I hereby authorise said
Bank & its officers to pay all such orders
& checks, in the same manner as if
drawn by myself.
Witness my hand, at Boston,
the 4th day of January 1847–
Witness
Peter Harvey
Danl Webster

it is drawn. The object of such a check is to have it first presented to a bank to whom the payee is known, and

whose indorsement will be accepted as a guarantee of the credit of the maker. When a check is crossed "in blank" —that is, has two lines drawn across its face with "& Co." inserted—it may be presented for payment to any bank




other than the one on which it is drawn; but when it is "specialized"—i. e., when it is crossed or has stamped across it the name of a particular bank—it must first be presented to that bank for payment. A law has been enacted in England which prohibits the payment of a crossed check by a bank against which it is drawn until it has been presented through another bank. If the drawer of a check knows the payee's bank he will usually "specialize" it; if his bank is unknown, the check is crossed "in blank," and the bank paying it is held for proper indorsement. The "crossed check" is a more secure form of negotiable instrument than the ordinary "customer's check." It is useless in the hands of the wrong person. We have reached practically the same end in this country by having stamped on checks intended for circulation as negotiable paper the words, "Payable only through . . . Clearing-House when properly indorsed."

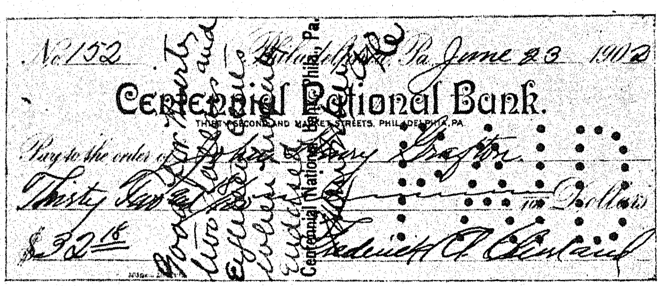
The use of the "crossed check" has given rise to an institution known as a "cheque-bank." This form of bank sells to its customers a book of its checks, the amount for

which each may be drawn being limited on the face of the check itself. For example: A book containing 50 blank checks, each of which may be drawn for the maximum amount of $10, may be purchased for $500. When the book is finally presented at the bank for settlement, the bank will return to the customer the canceled and paid checks; the difference between the amount of drafts actually made and the amount paid for the book will be returned to the customer, or credit will be given on the purchase of a new book. Check-books are made up of assorted blanks, to suit the customer's convenience. Such books may be had at the main office, or at any of the other banks which serve as correspondents of the "cheque-bank."

*The cheque-bank check.*

The "customer's check" is the instrument usually employed for the transfer of funds from one bank customer to another where business relations are such as to make them acceptable. It often happens, however, that a customer will find it desirable to have funds in a bank where he is not known, or will desire to make payment to one who does not care to take the risk of a private check. In such case some other form of instrument of transfer will be used.

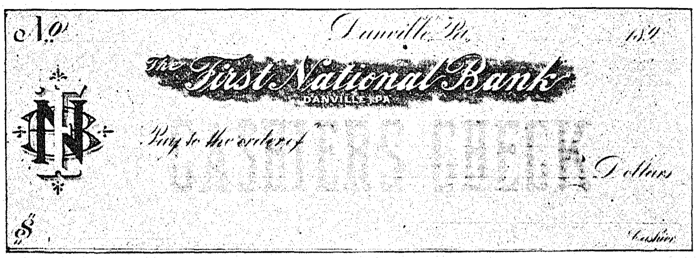
*Other instruments of transfer of credit funds.*




For this purpose one of the most common devices is the "certified check." The customer will draw his check for the amount desired, and this will be handed to the cashier

of the bank in which he has funds. The cashier will thereupon write across the face "Certified," or "Good when properly indorsed," over his official signature, and charge the same against the customer's account. This amounts to a transfer to the bank of the amount drawn, and a guarantee on the part of the bank that the funds will be transferred to the owner of the check on presentation. Another form is the "cashier's check." To obtain a cashier's check the customer will exchange his own check for that of the cashier—i. e., the

*The "certified check" and the "cashier's check."*




amount of funds represented by the check will be formally turned over to the bank, and the bank, through its cashier, will thereupon deliver its own instrument of transfer to the customer, made payable to such person as the customer may direct. Another form of instrument of transfer of credit funds used between banks is the bank draft. One of the most artistic engravings of this kind is given on the opposite page—a form of draft used by the "Biddle Bank" for business with its correspondents.

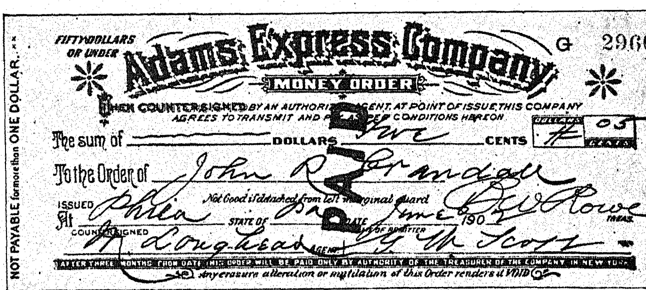
The money-order is an instrument of transfer of funds created for a special purpose. For example: One wishes to send $50 to a person residing in another part of the country. He will make a deposit, or in some manner create a $50 fund in the hands of a company or department of Government whose business it is to transfer funds. The fund having been created, the company or department will issue an order for the amount, payable to the person speci-

fied. This will be sent instead of money or other forms of funds. Money-orders are issued by express companies, the Bankers' Money-Order Association, and the Post-Office. A photo-engraved copy of an Adams Express Company order is exhibited on page 68.


*The letter of credit.*

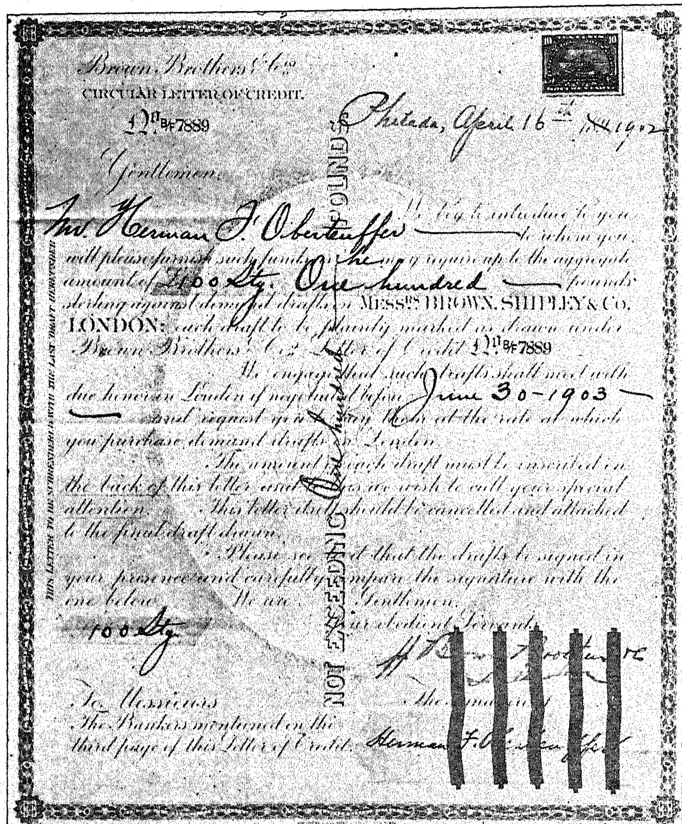
One may wish to travel in a foreign land —let us assume the estimated cost to be $1,000. It may not be convenient or safe to carry money enough to pay the expenses of the entire trip. For this reason some form of credit is preferable to money. With this in view, the prospective traveler goes to his banker. He arranges at the bank for a special credit fund of $1,000 to be drawn against at any time. But banks and business houses abroad will not accept a "customer's check" against an American bank. A "Letter of Credit" is therefore issued. The ordinary letter of credit is really a guarantee of payment of all "customer's checks" or drafts drawn by the holder to the amount stated in the letter. It is a "certified-account"

instead of a "certified-check." It has its advantages over a certified-check in that it allows the customer to draw just the amount needed at any time or place, and, upon identification, to have his check cashed in the same manner as a certified-check or a cashier's check. With the increase of foreign travel the letter of credit has become such a common instrument for the transfer of credit funds that every one should be familiar with its form and purpose. We reproduce on pages 69 and 70 a facsimile of the first and second pages of a letter of credit for £100 ($500). The first page is the letter guaranteeing the account, authorizing the various correspondents of the bank issuing it, or any other


NOT PAYABLE for more than ONE DOLLAR.
FIFTY DOLLARS OR UNDER
Adams Express Company
G 2966
MONEY ORDER
The sum of DOLLARS CENTS
To the Order of John R Crandall
ISSUED At Phila STATE OF Pa DATE June 190
COUNTERSIGNED
Not Good if detached from left marginal guard
Any erasure alteration or mutilation of this Order renders it VOID

banker to whom the letter may be presented, to pay to the holder any amount for which he may draw not to exceed the fund provided. In order that the fund may not be overdrawn, a second page is provided upon which are entered the amounts drawn. These entries are made by the bank officer himself at the time that the draft is paid, and give a complete account of the fund. The entries give the names of the banks to which the letter is presented, the place, and the amount paid by each. On the third page is the "Indication List"—i. e., the names of the bank's correspondents where drafts will be honored. The customer is not, in fact, limited to the correspondents of the bank issuing the letter, as the draft will be accepted at any place where the bank

of issue will be given credit. As a matter of safety and of greater ease in identification, the banker issuing the letter requires the one to whom it is issued to place his signature on the face of the letter itself. He also takes a number of



Brown Brothers & Co.
CIRCULAR LETTER OF CREDIT.
No. B 7889

Phila., April 16th 1902

Gentlemen,

We beg to introduce to you Mr. Herman F. Obertueffer — to whom you will please furnish such funds as he may require up to the aggregate amount of £100 Stg. One hundred — pounds sterling against demand drafts on MESSRS BROWN, SHIPLEY & CO. LONDON: each draft to be plainly marked as drawn under Brown Brothers & Co.'s Letter of Credit No. B 7889

We engage that such drafts shall meet with due honor in London if negotiated before June 30-1903 — and request you to pay them at the rate at which you purchase demand drafts on London.

The amount of each draft must be inscribed on the back of this letter and to this we wish to call your special attention. This letter itself should be cancelled and attached to the final draft drawn.

Please see that the drafts be signed in your presence and carefully compare the signature with the one below. We are, Gentlemen,

Your obedient Servants,

£100 Stg.

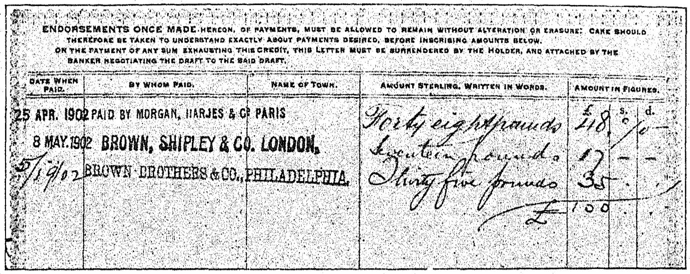
[redacted]

To Messieurs
The Bankers mentioned on the third page of this Letter of Credit.

Herman F. O[redacted]

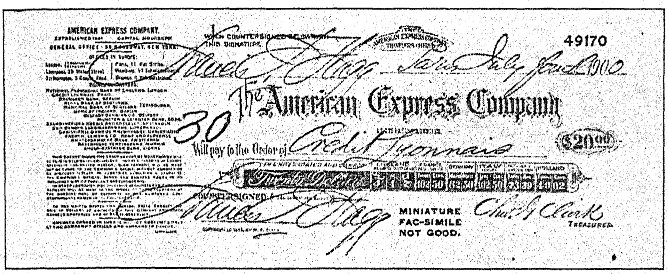
other signatures on blanks specially prepared for that purpose, and sends one to each of the leading foreign bankers drawn upon. In course of travel or business the holder presents his letter at one of the banks named on the "Indi-

cation List"; thereupon the cashier will ask him, in his presence, to sign a draft for the amount desired. After


ENDORSEMENTS ONCE MADE HEREON, OF PAYMENTS, MUST BE ALLOWED TO REMAIN WITHOUT ALTERATION OR ERASURE: CARE SHOULD THEREFORE BE TAKEN TO UNDERSTAND EXACTLY ABOUT PAYMENTS DESIRED, BEFORE INSCRIBING AMOUNTS BELOW.
ON THE PAYMENT OF ANY SUM EXHAUSTING THIS CREDIT, THIS LETTER MUST BE SURRENDERED BY THE HOLDER, AND ATTACHED BY THE BANKER NEGOTIATING THE DRAFT TO THE SAID DRAFT.

| DATE WHEN PAID. | BY WHOM PAID. | NAME OF TOWN. | AMOUNT STERLING, WRITTEN IN WORDS. | AMOUNT IN FIGURES. £ | s. | d. |
|---|---|---|---|---|---|---|
| 25 APR. 1902 | PAID BY MORGAN, HARJES & Co | PARIS | Forty eight pounds | 48 | 0 | 0 |
| 8 MAY. 1902 | BROWN, SHIPLEY & CO. | LONDON. | Seventeen pounds | 17 | — | — |
| 5/19/02 | BROWN BROTHERS & CO., | PHILADELPHIA. | Thirty five pounds | 35 | | |
| | | | £ | 100 | | |

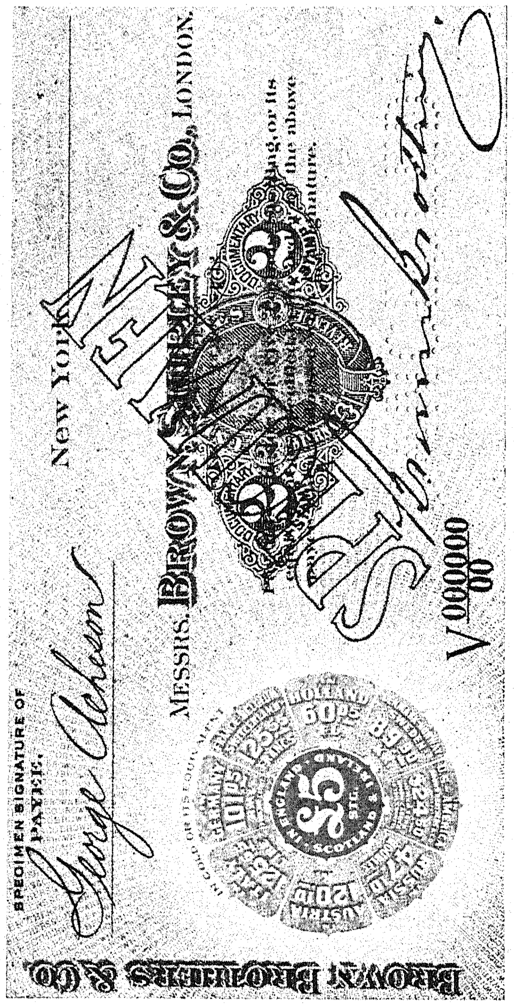
comparing the signatures, the cashier will enter the amount of the draft on the second page of the letter, and return the letter with the money drawn to the payee. Payment is usually made upon the simple identification of comparison of signatures. Should the traveler lose his letter of credit, he will at once notify the banks upon and by whom it is drawn.



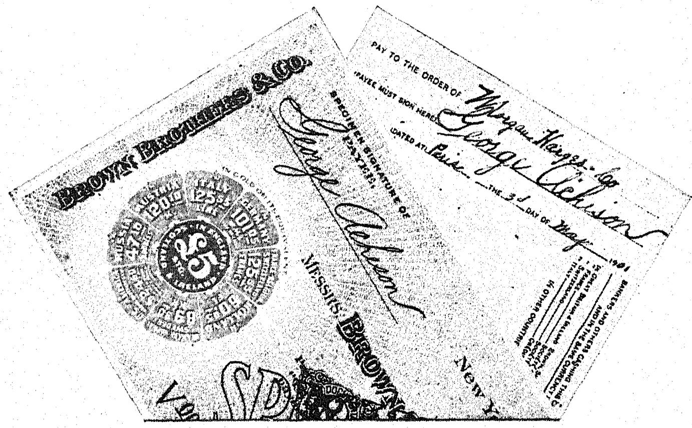

Another instrument of transfer of credit funds for use in travel has been devised by the express companies. This is most extensively used by the American Express Company, which has offices all over Europe. Over 10,000 agents are authorized to pay these checks. The ease with which they may be redeemed causes them to be received by hotels, railroads, and

*The "traveler's check."*

business houses about as readily as the money of the country. They are issued to the traveler in denominations of $10, $20, $50, $100, and $200, to suit the convenience of the purchaser. When issued, they are bound into a small check-book, and may be carried about as ordinary checks. Precaution against loss and for identification of the holder of a traveler's check is provided by having the purchaser sign his name in the upper left-hand corner at the time of issue. When the check is presented for payment he is again required to sign his name on the lower left-hand corner. The signatures must agree. The success of the American Express



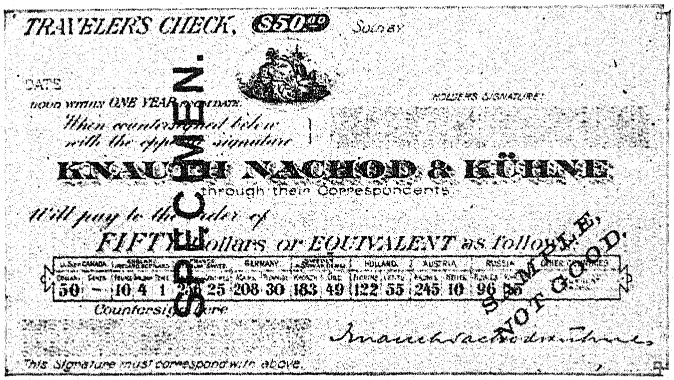
Company has led other foreign exchange houses to issue travelers' checks. A notable example is that issued by




Brown Brothers. This house, with its international connections and long-standing reputation for honorable dealing, has an established credit which will be taken in trade anywhere in the commercial world. Its checks have the advantage of being more difficult to forge. Instead of having both signatures of the customer written on the face of the instrument, where one will serve as a copy for the other, the one selling the check to a foreign house must indorse his signature on the back. The cashier may then fold the paper in such a manner that the writing may be compared, as shown in the accompanying cut. It will be noted that on the face of the check is indicated its money equivalent, or exchange value, in each country where it may be used. Another house prominent in international exchanges which has adopted this method of securing patronage from serving the foreign traveler is Knauth Nachod & Kühne. It will be noticed by reference to the exhibit on page 73 that their check is, in form, almost identical with that of the American Express Company.

*The interchangeable bank money-order.*

The money-order business of the country is enormous. As shown by the report of the Postmaster-General, the business done by the postal money-order department, in 1901, was $274,500,000, while the same class of business transacted by the express companies is estimated at $150,000,000 per year. With an aggregate of sales of money-orders amounting to $425,000,000 per year ($1,400,000 per day), the popularity of the traveler's check suggested that by use of an interchangeable money-order the banks could handle a large part of a business which produces in fees about $3,300,000 per year. Mr. Percival Kühne, of Knauth Nachod & Kühne, was among the first to recognize this opportunity. Calling


TRAVELER'S CHECK, $50.00

SPECIMEN.

DATE

HOLDER'S SIGNATURE:

KNAUTH NACHOD & KÜHNE

through their Correspondents

FIFTY Dollars or EQUIVALENT as follows:

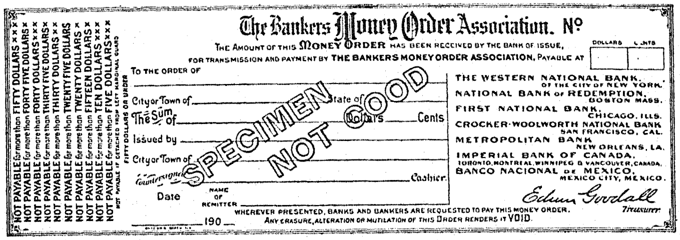
| U.S. & CANADA | | | | | | GERMANY | | | | HOLLAND | | AUSTRIA | | RUSSIA | | OTHER COUNTRIES |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 50 | — | 10 | 4 | 1 | | 25 | 208 | 30 | 183 | 49 | 122 | 55 | 245 | 10 | 96 | |

SAMPLE, NOT GOOD.

This signature must correspond with above.

together the secretaries of the various State bankers' associations, a bankers' money-order association was organized, with Mr. Kühne as its president. The avowed object of the association is to compete for the enormous money-order business, by allowing every bank which becomes a member of the association to issue interchangeable certificates. The Western National Bank of New York acts as a clearing-house for the other members. In other words, the order is in the form of New York exchange which will be accepted anywhere in the country. The banks are in a position of

advantage over the express companies, for the reason that the public is accustomed to dealing with the banks, and will find it an added convenience to purchase money-orders there.


NOT PAYABLE for more than FIFTY DOLLARS ×××
NOT PAYABLE for more than FORTY FIVE DOLLARS ×
NOT PAYABLE for more than FORTY DOLLARS ×××
NOT PAYABLE for more than THIRTY FIVE DOLLARS ×
NOT PAYABLE for more than THIRTY DOLLARS ××
NOT PAYABLE for more than TWENTY FIVE DOLLARS
NOT PAYABLE for more than TWENTY DOLLARS ×
NOT PAYABLE for more than FIFTEEN DOLLARS ×
NOT PAYABLE for more than TEN DOLLARS ×××
NOT PAYABLE for more than FIVE DOLLARS ×××
NOT PAYABLE IF DETACHED FROM LEFT MARGINAL GUARD
FIFTY DOLLARS OR UNDER

The Bankers Money Order Association. No

THE AMOUNT OF THIS MONEY ORDER HAS BEEN RECEIVED BY THE BANK OF ISSUE, FOR TRANSMISSION AND PAYMENT BY THE BANKERS MONEY ORDER ASSOCIATION, PAYABLE AT

DOLLARS CENTS

To the order of
City or Town of ______ State of
The Sum of ______ Dollars ______ Cents
Issued by
City or Town of
Countersigned ______ Cashier.
Date ______ 190__
Name of Remitter

SPECIMEN NOT GOOD

THE WESTERN NATIONAL BANK, OF THE CITY OF NEW YORK.
NATIONAL BANK OF REDEMPTION, BOSTON MASS.
FIRST NATIONAL BANK, CHICAGO, ILLS.
CROCKER-WOOLWORTH NATIONAL BANK SAN FRANCISCO, CAL.
METROPOLITAN BANK NEW ORLEANS, LA.
IMPERIAL BANK OF CANADA. TORONTO, MONTREAL, WINNIPEG & VANCOUVER, CANADA.
BANCO NACIONAL DE MEXICO, MEXICO CITY, MEXICO.

Edwin Goodall
Treasurer.

WHEREVER PRESENTED, BANKS AND BANKERS ARE REQUESTED TO PAY THIS MONEY ORDER.
ANY ERASURE, ALTERATION OR MUTILATION OF THIS ORDER RENDERS IT VOID.

*Place of credit in modern finance.*

The promotion and capitalization of the United States Steel Corporation furnished the leading sensation of the opening year of the new century. The principal dramatic feature, however, was not its magnitude,—other concerns of large proportions had been developed,—it was the suddenness of its rise. Within a few months scattered and isolated plants were reorganized financially, and grouped under wider and still wider management, until finally, with a rapidity that fairly staggered the world, all concerns were absorbed by one gigantic corporation—a billion-dollar "trust" was formed. Under a system of finance more primitive than our own this would not have been possible. The development of our whole modern system of economy lay back of it; the growth of great financial institutions was a necessary prerequisite. Let us suppose, for example, that we had lived in an age of strictly money economy; let us assume that it had been necessary to deliver coin to the amount involved in the transaction. If silver dollars had been used it would have taken one man fully five years to count out the change with business accuracy; five-dollar gold pieces would have shortened the process four years, but still a year would not have been too long a time. Under a money economy, this one necessity—the difficulty of count-

ing and making change—would preclude, absolutely, the large transaction of to-day. By the use of modern devices, the effort involved in this element of business is reduced to a minimum; a transfer of any size may be made by a simple stroke of the pen. Using more primitive methods than at present prevail, the process of accounting necessary to a consolidation such as that above referred to would have employed an army of men for months. Modern financial devices, modern financial institutions, modern systems of accounting, make the transferring of large interests a matter of a few moments. The settlement and adjustment of constantly changing business relations are quickly effected. The process of "clearing," for example, allows the financial interests of the whole continent to be adjusted weekly. By modern financial institutions, and modern methods of communication, the world's business may be brought into daily contact and adjustment, if need be. In New York, business to the amount of $150,000,000 per day is transacted and settled by the actual exchange of about $6,000,000 in coin. Between London and New York, business of something like $3,000,000,000 is kept in constant adjustment with the transfer of only about $150,000,000 in gold, and a large part of this is shipped for manufacturing purposes. Even a country store doing a $20,000 business, by modern economy is able to effect its exchanges, serve its customers, and settle its accounts in various parts of the world with the actual use of only $500. With a metal reserve worth a few billion dollars, held for safe-keeping in the vaults of the large cities—and with this reserve practically undisturbed—the commercial world is enabled to do its business without the use of any considerable amount of money-metal. Communities and nations are bound together by such financial and commercial ties that the merchant or the farmer in western Colorado or South Africa may purchase goods in Hongkong, New York, or Amsterdam without offering a grain of gold or silver in exchange, and with no greater

inconvenience than that of going to his local financial agent. Whether it be the organization and capitalization of a billion-dollar corporation or the purchase of a spool of thread, the same commercial solvent is applied, the same instrument of economy is employed. It is the use of a universal system of credit that distinguishes the business methods of the New World from the Old.

# PART II

# HOW FUNDS ARE OBTAINED

# CHAPTER V

## FUNDS OBTAINED BY GIFT AND INHERITANCE

*Primitive economy—The family.*

It has been observed by writers that exchange did not exist among the most primitive people. This may not seem strange when we take into account the chief motives for their association. The family, perhaps, represents the most primitive group, but its purpose is not industrial; its bond of union is found in *the instinct of love*; its race purpose is the propagation of kind; its plan of organization is one of cooperation for mutual comfort and for the rearing of children. To the family, industry is incidental rather than an *organic* principle. Its cooperation is based on the sacrifice of self-interest—on the devotion of the substance and energy of ancestors and adult members to the young and to the comfort of one another. As between members of such a group the necessities of life do not admit of commercial exchange without impairing the bond of sympathy and harmony which draws the members together and holds them in domestic relations. When, within the family, commercialism comes to be a dominant motive, when self-sacrifice and mutual devotion are relegated to a subordinate place, the family group itself breaks down—its component members attach themselves instead to commercial and industrial concerns, and the family organization is lost. Within the family, "gift" is the prevailing method of obtaining the means necessary to comfort and enjoyment.

A larger and broader association is developed. From motives of mutual aid families group themselves into clans and tribes; but in this, as well, industry is not the dominant interest. Mutual protection is the tie that binds. Security against external foes and internal dissensions is found necessary to the highest welfare of all. Within this larger group *public welfare* forms the dominant principle of organization; but the race advantages of a smaller group for the propagation of kind (the family) cause it to persist within the tribe; this still remains the unit for the care of the young, the unit of cooperation in ministration to want, of common devotion to the comfort and enjoyment of its members. Both principles, however, being essential to the race, the clan or tribe (based upon the principle of protection), and the family (based upon the principle of common devotion), are brought into harmony one with the other. The protection secured by political organization gives more favorable conditions to the family,—conditions better adapted to the highest development of the individual members of the race; the social training within the family, the authority exercised, the order established and maintained among its members, better fit them for the broader tribal relations. In the family group the various dependent members are supported by "contributions" of those in control; with the larger political group those in control are supported by "contributions" of their dependents.

*The clan and the tribe.*

Other groups may be cited in which exchange is not necessary to harmonious and effective cooperation; but these, it should be observed, are also non-industrial in character. The Church, the club, societies—religious, educational, fraternal, and social, of which many might be enumerated—have for their dominant principle interests that are non-industrial. Each of them is dependent upon an industrial group for maintenance and support. Each of them has a significance in

*Other non-industrial groups.*

industrial development, and to each, industrial cooperation is essential. These social groups have a bearing upon our subject, in that they strengthen the bonds of association, and in their purpose give direction and character to the organization of industry. Being non-industrial, however, without independent income for their support, a large part of their "maintenance" must come from "gift," or some other form of "contribution," as distinguished from "exchange."

*"Gift" the funding method of dependents.*

It is out of a condition of industrial "dependence" that "gift" and "contribution" arise; as before suggested, it is with this method of obtaining funds that we first become acquainted. The helplessness of the child, the necessity for care and protection during that period of life when he is attaining strength and vigor, throws on the parent the duty and necessity of providing for his maintenance. In primitive societies both males and females are industrial. With the development of art and invention and the means of supplying want in greater abundance, the father becomes the directing agent of productive enterprise, while to the mother is given over the care and training of the child. This increases the number of dependents; to the infant dependent class is added the adult females of the family; and with the increase in the number of dependent members arises an increased necessity for contribution by "gift." As civilization advances, as the period of training lengthens, the period of dependence also grows. Children get their first spending money from the hands of their parents; as they grow to maturity, that instinct which is so necessary to the maintenance of the child during his infancy follows the ancestor; the interest which the parent feels in the development of his offspring is consideration sufficient to cause him still to extend the means necessary to maintenance and comfort. This first goes out in the form of providing training which would better fit the youth to move

and act with his fellows in the varied circles of life. In this the aim of parents is so to equip their offspring that they may enter into the complex relations of life capable of making judgments and of understanding the conditions necessary to highest success. Their hope and their aim are to raise the young, through a longer period of *dependence*, to a place of highest *independence*. This preparation, from the beginning, involves the use of funds, but in most cases the experience of the young is limited to the one way of acquiring them—viz., voluntary contribution.

Where "exchange" becomes established as an essential part of industrial economy, "contribution" necessarily takes the form of "funds" as the more effective means of granting support. Mother, child, missionary, priest, church organization, social or fraternal society—every person, or non-industrial institution, that holds a position of *dependence*, must look to the gifts and other forms of contribution of those in control of industrial income for their means of support; they must rely upon the strength of the "ties that bind" the possessors of funds, upon their regard for kin, their desire for social advancement, or their response to ideals of higher civilization and progress, as a basis for their claims.

*"Gift" and contribution usually take the form of "funds."*

Inheritance is simply one form of acquisition by "gift." It rests on the assumption that the properties acquired by the ancestor, which he himself does not use during his life, and which are not disposed of to others during his life, are *intended* to be *given* to his heirs. The child, during his minority, has been a dependent; for his support he has relied upon gifts. When he has reached his maturity, the same interest and regard which caused the father to *give* support and provide social and educational advantages, suggest the propriety of *giving* the boy his "start" in the business world. He recognizes the ad-

*Funds obtained by "inheritance."*

vantage of capital for business—of initial funds for the organization and management of industry. He knows that without some contribution of this kind his son for years will be unable to exercise his highest talents in the enterprise which he has undertaken as a life work. Funds are therefore provided by the parent for the business activity of the son, as they have been given before for support. With the family as a unit in social organization, with the law of property as the underlying industrial principle, *inheritance* passes into our system as a part of the law governing our institutional and social life. *It is assumed* that the ancestor, unless he otherwise bequeaths his property during his life, would have divided it among those dependent upon him at his death; that it is in their interest and for their welfare that he has put forth the effort to obtain the funds and properties which he possesses, and that this advantage would be preserved to the members of the family were his will expressed in a formal act. An acceptance of the principle of "*trusteeship*," however, as laid down by Mr. Carnegie in his Gospel of Wealth, would give quite a new application to the law of inheritance. Mr. Carnegie says that the acquisition of wealth is the result of a great cooperative process in which the whole society of workers (dependents as well as non-dependents) take part; that for the purposes of carrying on this process to the highest advantage of all, some must give direction while others must attend to the minute details. Each and all, however, have assisted in the production of the *means* of enjoyment. While cooperation is advantageous for the purposes of producing the *means* of enjoyment, it is only by distributing this to the individual members that the *means* may be enjoyed—i. e., the *means*, thus produced, must be applied to a *use* which will give satisfaction to individual want, and this can best be determined by each member for himself. Or, to put it in another way: while there is advantage in cooperation, the principle of personal freedom requires that this cooper-

ation must be voluntary, and both the product to be used and the *use* to be made of the product must be determined by the individual who feels the want. No man shall be a slave. As a means of securing personal freedom and at the same time of obtaining the benefits of cooperation, the amount to be distributed to each as a return for cooperation must be left to a previous arrangement. Now, as Mr. Carnegie reasons, if under these arrangements or contracts of free cooperation the managers and directors have left to them a large surplus—a surplus disproportionate to their service, and disproportionate to their own needs and the needs of those dependent upon them,—then these men should consider that they hold this surplus as a fund "in trust" for the whole society. To quote the words of this great director of cooperative industry, whose feeling goes out toward his fellows, and who with his enormous wealth has taken a large social view of his responsibility, it is the duty of the man of wealth "to set an example of modest, unostentatious living, shunning display or extravagance; to provide moderately for the legitimate wants of those dependent upon him; and, after doing so, to consider all surplus revenues which come to him simply as trust funds, which he is called upon to administer in a manner which, in his judgment, is best calculated to produce the most beneficial results to the community—the man of wealth thus becoming the mere trustee and agent for his poorer brethren, bringing to their service his superior wisdom, experience, and ability to administer." The application of the principle of *trusteeship* to the law of inheritance would very much enlarge the responsibility of the man of wealth. If accepted by the ruling majority of our people, the man in control of affairs would be regarded very much in the light of the manager of a large corporation in which the whole country were stockholders. Each one who labors in the common cause labors for an agreed salary or wage under the manager; the managers or directors are also entitled to vote for themselves a fair com-

pensation—a competence with which to care for those dependent upon them; these salaries, wages, and deductions should be considered in the nature of expense of operation; net earnings, however, belong to the whole corporation; they should be considered as *a fund* in the hands of the manager for distribution according to the obligations of the corporation to society, and are not for the benefit of its directors. On dissolution, the full assets of the company should be converted and distributed to the community as its stockholders.

*Industrial importance of gift and inheritance.*

The importance of the principle of inheritance, however applied, can not be overlooked. For the dependent—the recipient of funds obtained from ancestral contribution—an inheritance often obviates the necessity of securing capital equipment by means of a long process of accumulation (or saving) out of earnings; it shortens the time necessary to acquire a fund sufficient to equip any business enterprise to be undertaken. It increases the opportunity and advantage of those members of the community who, having been well supplied with funds, have had opportunity to avail themselves of the highest training, and who may therefore be best able to give direction and control to the affairs of the community. This advantage, however, may be lost. Opportunities may be wasted; absence of necessity may remove the stimulus to effort which is essential to the development of cooperative industrial capability. The one to whom capital has passed by "gift" or "inheritance" may show himself unable to utilize capital to advantage. In such cases, by the very contest into which the business man is ever thrown and in which capital itself must be employed in order to become productive and return to its possessor an income for support, the properties of the incompetent pass over and become subject to the control of those who can use them to higher advantage. But when large productive estates or interests descend to those who have not a proper

appreciation of their responsibility, or who have not the ability or energy to give the best direction to their use; when, by incompetence or waste, productive properties finally pass over to the control of those who are "not fit," there is a loss to the whole society, not only from the "waste" of the wealth which has come into the hands of the socially unfaithful, but by the "waste" of social force which comes from the disorganization and displacement occasioned by the breaking up of one scheme of cooperation and the readjustment and reorganization made necessary by the new.

*Laws of inheritance.*

The law of inheritance is a rule which has grown out of the common impulse to care for and support dependents; this impulse was evolved at a time when the producing power of a group did not more than suffice for support of its members—when the family was the all-important race factor. It is an expression of the common experience and common motive of the race directed toward its own perpetuation. Before the death of the ancestor all property acquired during life "belonged" to him; by operation of the law of inheritance the property of the ancestor passed to his natural heirs according to an established rule of descent, unless the common law or rule is varied or set aside by a formal expression of the "will" of the ancestor, in which case "the last will and testament" governed. The formal expression of the decedent's "will" is known as a "devise," and the property or funds inherited in this way are said to be "devised"—i. e., they are passed on by him to others in the same manner as if he had disposed of them during his life. Laws controlling inheritance are necessary and wholesome. Laws controlling inheritance, however, may have the effect of protecting the use of funds and properties in the hands of the incompetent. Where such laws exist, the effect is to change the relation of dependence from one based on social welfare to one carrying with it social degeneration. Industrial dependence which is found to exist

between members of a family, and which is incident to the maintenance of the church, to the support of fraternal and social organization, is the result of the sacrifice of a lower to a higher interest. The perpetuation of race in greatest strength and vigor, the fostering of social and educational ideals, mutual protection and general welfare, are as necessary to a people as is physical maintenance and support. To this end many persons in our society have accepted places of industrial dependence in their devotion to higher interests. For this reason it is held by many of the great social and industrial leaders of to-day that those who are engaged in control of the industrial or business pursuits, and into whose hands the properties and incomes of the industrial society come for distribution, must be regarded as holding them "in trust" for all the members who are devoting their lives to common well-being. Laws of gift and inheritance which stand in the way of such a distribution as will further this interest, which condone "*breaches of trust*" —laws which have been developed from ideals of private monopoly, and which have come down from those legal systems in which "arbitrary power" took the place of the more modern notion of free cooperation based on "general welfare"—are constantly the subject of legislative modification and political interest. Many changes have already been made, notable among them the abolition of the rule of primogeniture. It remains only for the great political society to determine in this, as in all other matters of public interest, what rules of social cooperation they shall establish.

### Funds obtained by "Appropriation"

The idea of appropriation is one quite different from that of gift. As before observed, gift is based on relations of industrial dependence. "Appropriation," on the other hand, proceeds from a notion of superiority or control. It is the method commonly employed by government as a means of obtaining funds for its support. It is the method

commonly employed by those engaged in many forms of industrial pursuit for obtaining those things from nature which will be useful to mankind but which have not yet been reduced to the control of others. Man has certain wants which he would supply. Around him is nature endowed with all the materials which are necessary to the satisfaction of want. To make these materials available to this end, however, they must be "appropriated"; the ore must be extracted from the mine, fish must be taken from the sea, the timber of the forest must be reduced to ownership in forms which will be useful for supplying human needs. In primitive times among a primitive fishing people, when dried fish was used as money, the individuals of the community procured their funds by means of appropriation. Among a hunting people, skins of beaver and mink or the hides of other animals which served as money were procured in the same way. Among a primitive agricultural people wheat and barley served the members of the tribe for funds, and under a primitive industrial *régime* the metals obtained by the various members of the tribe or clan were passed from hand to hand as money, with no common stamp, design, or official voucher for weight or fineness such as is known to our modern systems of finance. When, however, commerce and industry developed to such an extent that more careful judgments and closer estimates of value were made in exchange; when the uncertainty of weight and fineness of the coins or metals used came to be an obstruction to commercial and industrial progress; when by common consent some uniform standard of judgment was demanded in trade, and the coinage of money was placed in the hands of a central agency of government which would give it character and undoubted integrity, then appropriation as a means of obtaining funds was abandoned. The only method other than that above described as pertaining to industrial dependence, was that of "exchange."

*"Appropriation" a primitive method of obtaining funds.*

# CHAPTER VI

## FUNDS OBTAINED BY EXCHANGE

"Exchange" is the common method of obtaining funds—the only method that belongs properly within the field of business. A young man may have capital given to him by his father with which to begin a business career; by "will" or bequest he may receive a certain amount of money or other funds. Usually when other property is inherited, this will not serve the purpose of the one inheriting it unless he takes up and carries on the business of his father. Except in such cases, therefore, he will convert into funds the property inherited and then apply these to his own uses. An inquiry into the prevailing financial methods of obtaining funds, therefore, is limited almost wholly to exchange. The significance of this fact is that (except when funds are received by gift) the only way in which a working capital may be obtained is by having something to sell—one must have something to offer, something for which others will give money or credit which may be used as funds.

*Limit to funding power.*

In this appears the limitations of men in their efforts to secure capital; in this may be found the reason why each of us may not obtain all the capital funds that may be desired. Before we can fund our enterprise we must have something which those possessed of funds will receive in exchange for them. The idea so often found in the literature of money and credit that certain forms of funds need have no value, that they

may be created by "fiat" of Government or by the "dictum" of some arbitrary or influential person, is absolutely without foundation in business experience.

*Capitalists.*

The capitalist of to-day is the man who has funds for sale; he is a funds merchant. He sells his funds only when in his judgment he gets something in return which will be more valuable to him than the funds sold. He trades on precisely the same principle as the hardware merchant or the fruit dealer; the only difference is that the latter offers his wares for funds, while the capitalist offers his funds for other properties—usually for investments. One should no more expect to obtain capital funds without offering something in return than one should expect to obtain groceries or clothing without giving a *quid pro quo.*

*What may be offered for capital.*

Let us suppose for a moment that you were about to begin business; that you had not inherited any property from ancestors; that you had received nothing by way of gift with which to "make a start in life." How would you proceed to raise the funds necessary? What would you have to sell? What could you offer to the man of means—the capitalist, the funds merchant? This question may seem entirely outside the field of finance. Not so. It is here that finance begins. It is this beginning that takes thousands of men and boys to the workshop.

### Sales of Labor

In going out for employment laboring men are answering this question in a practical way. What have they to sell? Their labor; their ability to serve those who have capital. Funds to them, as to others, have a double significance: (1) The first necessity that the laborer must face is that of maintenance. His power to serve others depends on his maintaining himself in strength and vigor. His income depends on continuous service. Unless he can so sus-

tain himself as to serve with ability those to whom he sells his labor, income will cease. The first necessity, therefore, is for "maintenance funds." Let income fall below this mark and all possibility of industrial independence is gone. (2) The second problem to be solved in the funding scheme of the laborer is so to dispose of his services as to leave a surplus over and above the expense of maintenance—something which may be laid by as "capital surplus." It is by use of this surplus that his industrial equipment must be procured. To procure the capital funds necessary to equip a business undertaking requires a long-continued process of exchanges of labor for wages, of saving a surplus, of accumulating this surplus into a fund which will be sufficient for his purpose, of expending it for "investments" or for "betterments." Assuming that you have nothing else to offer, this is the only means possible by which you may procure capital for business.

*Saving.*

Saving is the process whereby capital funds are accumulated from surplus earnings. Capital funds acquired from earnings are the remainder after the subtraction of expense and recoupment of losses. In the early part of the last century, when industrial capital was small, the problem of saving was the most important one considered by economists and writers on finance. At that time the problem was one for the individual to meet single-handed; to-day large financial companies are organized to facilitate saving—to help the laborer accumulate a capital. The small savings of the many are accumulated into large funds, which not only serve as a protection to the laborer himself, but which in the mass of accumulations furnish capital to large enterprises that give him further employment.

In this relation appears the importance of business training. The man who is trained only as an ordinary laboring man, the man who can not do more or better in serving those who possess means than any other man on

the street can do, must compete with him in the market. Among the many competing for work, some will be found who are willing to exchange their services for a wage barely sufficient to maintain them in bodily strength and comfort.

*Importance of training.*

If one is able to do only such work as these offer to do, then one must bring his standard of life below theirs; otherwise no margin or surplus will be left for capital use—a fund can not be acquired by saving. It is only by adopting a low standard of living that the Chinaman is able to "save." But what is your advantage if you have superior training? While perhaps you have inherited no money, have had no capital funds given to you by family or friends, you have a "gift" which has quality quite as productive of income. More than that, while you retain your faculties you may always maintain an advantage over the ordinary laborer. It is this in part which has inspired your natural guardians to devote so many years to your training. Without a dollar, you are able to go out into the world, to maintain a standard of life that allows you still further to develop your faculties, still further to handicap your competitors, or to lay by "in investment" an increasing fund with which you may finally equip yourself for the successful employment of the skill and labor of others in the management of a business of your own.

## Sales of Tangible Property and Business Interests

*Sale of goods produced by labor.*

Instead of selling your labor to others, instead of exchanging your services for income in the form of wages, you may decide, after the first funds are saved, to begin business in a humble way on your own account. Possibly you may undertake the business of shoemaking. Having saved enough to buy a small outfit, a few sides of leather, and having enough for a month's living besides, you may leave the factory where you have been employed and open a shop of your own. Let us

suppose that one pair of shoes may be made in a day, and that the cost of materials and of living were $3 per day. It would not be long before all your funds would be exhausted; but, instead of funds, you would have the products of your labor. Funds for future production must come from the sales of these products. If each pair of shoes might be sold for $5 per pair, then, if there were no items of loss, you would have a profit of $2 on each. This amount, by a strict economy, might be added to your capital. Accumulated funds from sales of shoes would allow you constantly to increase your business equipment. If, on the other hand, you were unable to dispose of your product in competition with the factory for more than $3 per pair, then a bare living would remain—your business would just pay expenses. A further reduction in price would cause your capital funds to disappear; it would become necessary for you again to fall back on the sale of your services to others. To those successfully employed in the management of industry, the chief source of revenue is from sales of the products of labor.

*Sales of property not adapted to capital employment.*

It often happens that one has properties not adapted to capital use. A private residence or a large private park is inherited; investments that yield a fixed interest or rental may be owned. These are not funds for business; they can not be utilized to advantage in the enterprise about to be undertaken. To one so situated the most practicable way of obtaining funds may be by the sale of these properties. By conversion of these forms of wealth into capital funds a business may be equipped which will produce income in the form of profits.

The shoemaker after equipping a factory may recognize a better business advantage in another locality. He may find that by moving to an inland point he can get water power where now he is required to use steam. The growth of population in new territory and the building of

new railroads may give advantages for obtaining raw materials, and at the same time place him within range of a general market for his goods. He can not remove his plant, however, to advantage. Much of the machinery would not be adapted to water power. He decides to sell his plant for what it will bring, as a means of obtaining funds for the new enterprise. A miller may have inherited a cotton factory from a brother. Every business advantage suggests the propriety of disposing of the cotton plant and using the funds to further his milling interests. This is one of the most common methods of obtaining funds in a country where industries are constantly shifting, as in our own.

*The sale of one business interest to capitalize another.*

Labor and tangible property are not the only things that may be exchanged for funds. Business interests may likewise be disposed of. Let us suppose that the miller has been making a considerable profit out of his business. But it appears that a still larger return may be had if he doubles his capital. His plant is a comparatively old one; he is now grinding 50 barrels of flour per day at a cost of $1 per barrel. Yet, owing to his favorable location, he is able to make a profit of $1 per barrel in competition with others. By the addition of as much more capital (say $50,000), by using it to put in improved machinery and labor-saving devices, he would be able to grind at a cost of 50 cents per barrel and turn out 200 barrels per day. Instead of having a profit of $50 per day with a capital of $50,000, he would with his better equipment get a return of $300 per day on a capital of $100,000. But how is he to obtain funds? He can not hope to raise the money from the sale of his services. His profits are already greater than would be the return in wages. He can not afford to wait until, by sales of goods produced, he may accumulate $50,000 more in funds. He has no properties other than those already

*The sale of business interests.*

employed in his business. He decides, therefore, to obtain the additional capital by selling an interest in his enterprise.

*Sale of partnership interest.*

Fortunately he finds another miller who has $50,000 in funds, and who is looking for a business opening. The books of the mill are gone over and its present earning capacity is calculated; the cost of improvement and the probable increased earning power is computed; the whole situation is carefully canvassed. Each of the two men looks into the business standing and reputation of the other. They finally come to an agreement. The first miller sells a partnership half-interest in his concern upon the condition that the second miller will put in $50,000 more of funds. With this the mill is newly equipped; there is an increased return in profits to each.

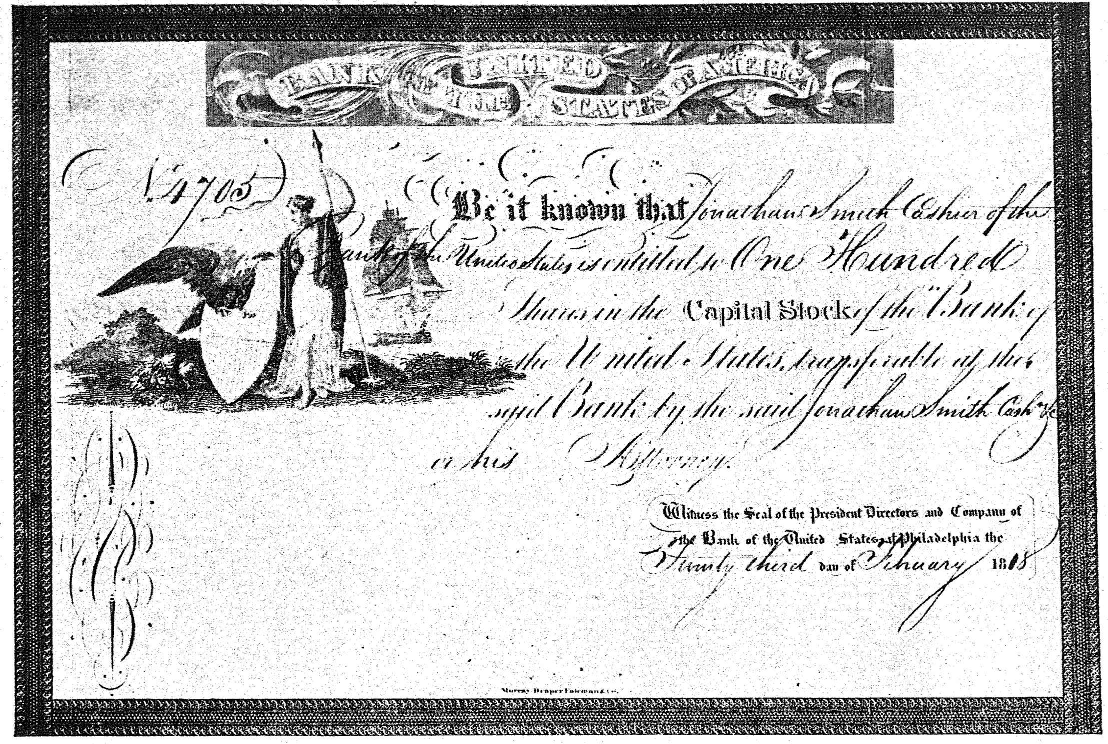
*The sale of corporate shares.*

With the development of the wheat supplies and the wheat-growing resources of the vicinity in which the mill is located, the partners find that they are still unable to supply the market with flour at a price that gives them a handsome return in profits to the company. Three-fourths of the wheat grown in the vicinity is shipped away for grinding, while they are not using more than one-third or one-quarter of the water power already developed. The question again arises, How may they obtain the capital with which to equip their industry in such a manner as to take advantage of the present business situation? To do this will require an expenditure of four or five times the amount expended in their present plant. They find no other miller who wishes to join with them in the business; they have no properties to sell by means of which they may secure the funds. They finally decide to incorporate the business—i. e., to offer shares to those who have capital to invest, but who are not millers, and who would not care to participate as partners. By placing shares at $100 apiece on the market, they are able to sell 2,000 shares. In other words, they find that they are able to obtain $200,000 additional capital made up

of income from the sale of proprietary interests in the corporation to stockholders. With the additional $200,000 they build two other mills of capacity and equipment similar to the first.

*Capital stock.*

Capital stock is the total amount of capital funds of a corporation invested by its shareholders. The certificates of interest held by investing members are called stock. Another term commonly used is "shares." This term is almost exclusively employed in England. There, "stock" has the same significance that the term "Government security" has in America. The stockholders of a corporation are those who make the joint contributions to the capital funds or capital stock of a corporation. They have (1) such corporate rights as: To participate in the organization of the company, to attend meetings of stockholders, elect officers, to hold meetings for the purpose of determining the powers to be granted and the rules governing their officers and agents, to give direction to the general policy of the corporation through the officers elected, etc.; (2) the financial rights, *first*, to share in the dividends set apart for the shareholders out of the net profits of the business of the corporation; and, *secondly*, to have a share in the capital distributed to the stockholders after the corporation proper has been sold and its affairs wound up. While the corporation exists, however, the stockholder has no right to touch a dollar of its assets or transact any of its business. The capital once contributed becomes the property of the corporation absolutely. The stockholder may be said to have sold a certain amount of his money, or credit, or other property, to the corporation, and in return has received one or more shares of its capital stock, the amount being estimated in the funds-equivalent or price of that which has been sold. For example: In the organization of a corporation a certain amount of the stock may be issued in exchange for plants purchased at an agreed price, while other



BANK OF THE UNITED STATES OF AMERICA

No. 4705

**Be it known that** Jonathan Smith Cashier of the Bank of the United States is entitled to One Hundred Shares in the Capital Stock of the Bank of the United States, transferable at the said Bank by the said Jonathan Smith Cashr &c or his Attorney.

Witness the Seal of the President Directors and Company of the Bank of the United States at Philadelphia the Twenty third day of February 1818

Murray Draper Fairman & Co.

shares may be sold for "cash." No one may transact any business for the corporation except a duly authorized officer or agent. The business of a corporation is in the hands of its officers. The assets of a corporation belong to the corporation as fully and completely as the moneys in the Treasury of the United States belong to the Government. A stockholder has as little right to appropriate assets and to attend to the business of the corporation as has a private citizen to take money from the public treasury or to attempt to do the business of the Government.

*Stock certificates.*

A stock certificate is the written evidence of a proportionate amount of the total capital which has been invested by a single stockholder in the stock of a corporation. The capital stock of a corporation is usually divided into shares having a funds-equivalent of $100 each. That is, if a company were organized with a capital of $100,000 they would have 1,000 shares of stock to sell. Each person who buys or subscribes for "stock" receives a "certificate" which indicates the number of shares which he has purchased by exchange of money or other property.

*Difference between corporation and partnership.*

The differences between a corporation and a partnership are many. In the first place, each partner may transact any business for which the partnership was organized, and each partner is liable for all the debts of the partnership. In a corporation, however, the stockholders have no right to transact any business of the concern, this being left to the properly appointed agents, and the stockholders are not liable for the debts of the company. With the death or withdrawal of a partner the partnership becomes dissolved, and the business of the partnership must be wound up. The death of a stockholder does not in any manner affect the life of the corporation. Its business may go on regardless of stock ownership. A partnership interest may not be sold without the consent of the other partners; a stock


UNITED STATES STEEL CORPORATION
COMMON CAPITAL STOCK
INCORPORATED UNDER THE LAWS OF THE STATE OF NEW JERSEY
SHARES 100
HUDSON TRUST COMPANY,
TRANSFER AGENT
ONE HUNDRED
COMMON CAPITAL STOCK
SHARES $100 EACH

certificate may be transferred at the pleasure of the owner. The responsibility of a stockholder is generally limited to the amount of his stock purchase. If the business is poorly managed he may not receive dividends on his stock; through the bankruptcy of the corporation he may even lose his invested capital; beyond this, however, he is seldom held liable. In some cases, as in banking concerns, stock liability is somewhat enlarged, and the stockholder is held responsible in double the amount of his investment.

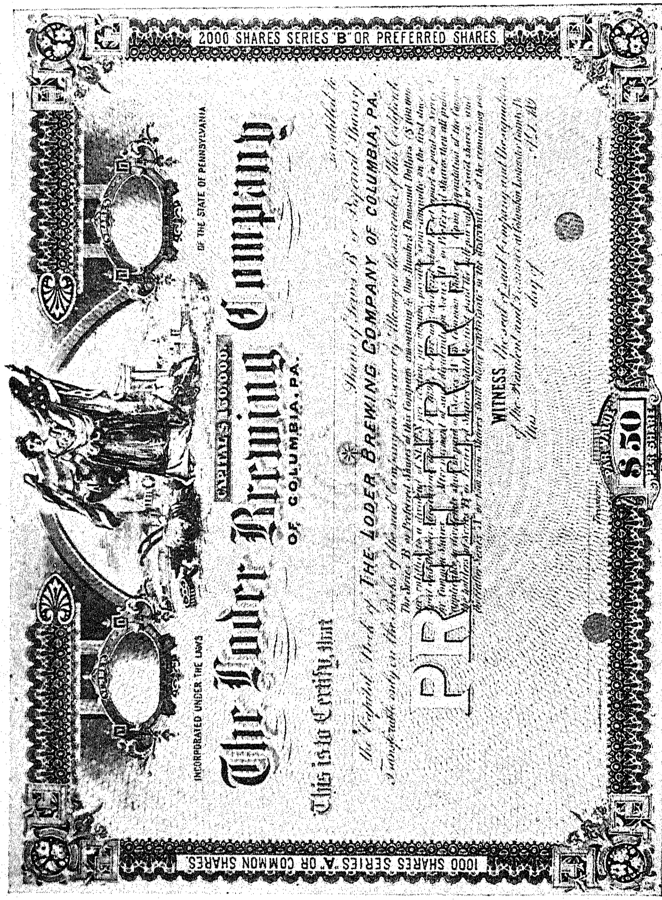
*Financial advantage of the corporation.*

Aside from those above enumerated, the advantage of corporate organization is found in the amount of capital funds or funds-equivalent of property that may be secured in this way. So long as it is made to appear to the investor that he can obtain a fair return in dividends, there is practically no limitation to the amount of capital that may be drawn together by the sales of stock. Being assured of competent management, the man with $100 may contribute with the same degree of confidence and the same prospect of return as the man with $1,000 or $10,000. The only limit to capitalization is found in the limit of profits. The fact that the business itself is a local one, however, may so far confine the knowledge of its management and of its profitable character to its managers that but few persons having funds to invest will care to purchase shares; such an industry as milling, therefore, is usually confined to a local investing constituency.

*Common stock.*

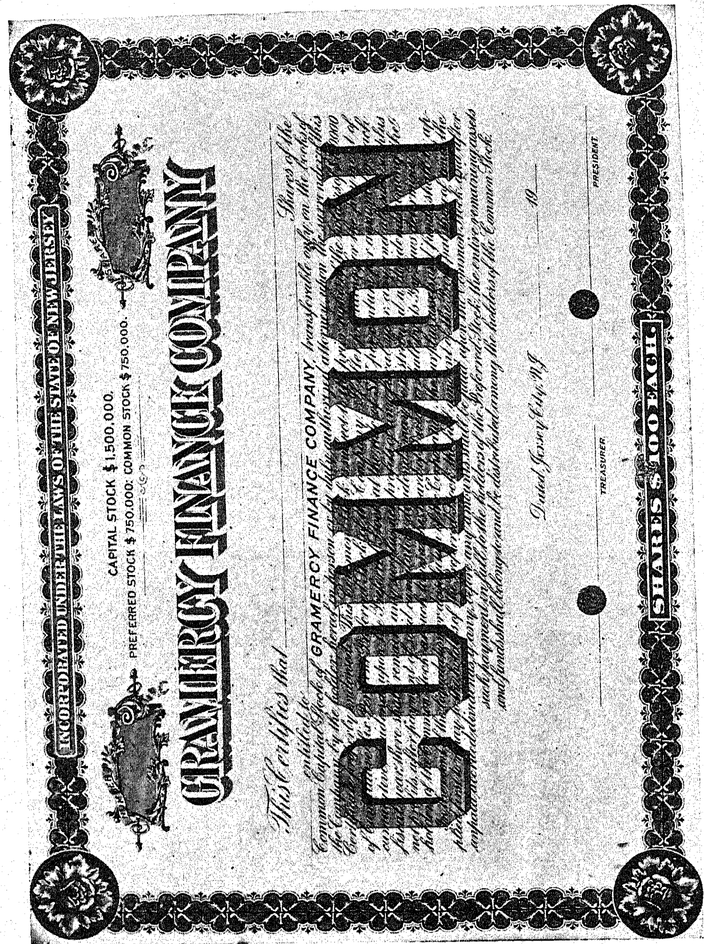
The partners to the milling enterprise had found a market for 2,000 shares of stock. Besides, the old plant of the partners was turned into the corporation at a valuation equal to $100,000; in the new corporate concern each of the partners was given $50,000 worth of stock. This made the total capital stock $300,000. These contributions were all made under similar conditions and conferred on the purchaser similar rights. The common stock of a corporation is that repre-

senting the interest of contributors of properties or funds who are entitled to dividends and to exercise corporate powers without preference.



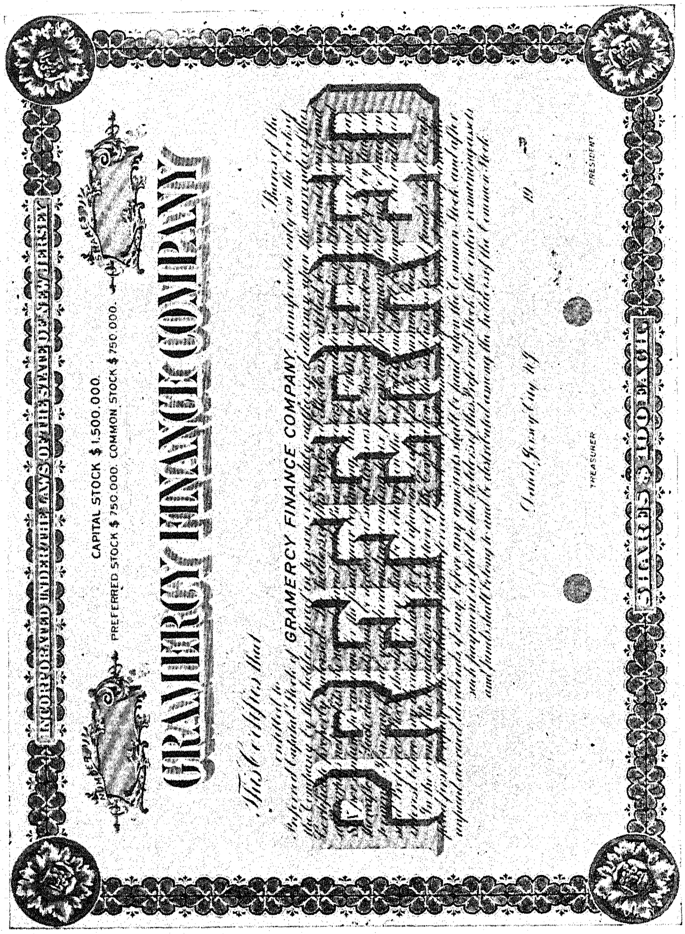

After the expenditure of the $200,000 contributed, the wheat-growing region suffered a drought, and the supplies of wheat for milling fell so far short of former yields that

the plant could not be run to more than one-third its capacity. Moreover, the wheat was of inferior quality, and




the flour produced could not be sold at a profit in competition with flours ground in other places. At the end of a year it was found that the milling company had suffered a

loss of $50,000—had incurred a floating debt, payment of which was demanded. This gave rise to a new situation—


INCORPORATED UNDER THE LAWS OF THE STATE OF NEW JERSEY
NUMBER
SHARES
CAPITAL STOCK $ 1,500,000.
PREFERRED STOCK $ 750,000. COMMON STOCK $ 750,000.
GRAMERCY FINANCE COMPANY
This Certifies that
GRAMERCY FINANCE COMPANY
PREFERRED
TREASURER
PRESIDENT
SHARES $100 EACH

a new demand for funds, one which could not offer a "profitable" business as a funding base. Under such circumstances the common stockholders decided to hold a

meeting to determine how the $50,000 might be raised. They did not feel disposed or able to purchase more shares in the stock of the corporation. Another expedient, however, was at hand—the issue of preferred stock. The preferred stock of a corporation is usually given to secure some obligation of the company or to meet some special demand for capital when common stock may not be disposed of to advantage. To this class of stock are given special dividend privileges—that is, this kind of stock is entitled to a preferred claim against the profits of the company. If a man holds a share of preferred stock he will receive dividends on it before any dividends are given to the common stockholders. The contract of preferment, as in the case of the Loder Brewing Company, may also give a first claim to holders of preferred stock on distribution of funds in the dissolution of the company—the preferred stock may be given a right to have its proportion of capital repaid before any distribution is made to the common stock. This being a bad year for the mill, and there being a prospect for a future profit, such an arrangement allowed the common stockholders to dispose of preferred shares for funds with which to pay the floating debt of the corporation.

*Preferred stock.*

There may be several kinds of preferment—e. g., the common stockholders together may decide to offer to those who will contribute new capital, a preferred right to have 6 per cent dividends paid to them out of the funds set aside for the payment of dividends before the common shareholders shall receive anything at all. Again, an agreement may be made whereby the preferred stockholder may have a first distribution of 6 per cent in preference to the common, and then after the common stock shall have received 5 per cent, if there be any profits remaining, the preferred stockholder may have a preferred right to 3 per cent more.

*Kinds of preferred stock.*

If, later, another contribution becomes desirable, and the


ORGANIZED UNDER THE MANUFACTURING LAWS OF OHIO

No. 293.

34993 Shares.

STANDARD OIL COMPANY.

CAPITAL STOCK
$3,500,000.
ALL PAID.

35,000 SHARES
$100 EACH.

This is to Certify that Trustees of Standard Oil Trust
is entitled to Thirty four thousand nine hundred ninety three Shares of One Hundred Dollars each
in the Capital Stock of the Standard Oil Company, [illegible]

Cleveland, [illegible] 188[illegible]

H. M. Flagler Secy

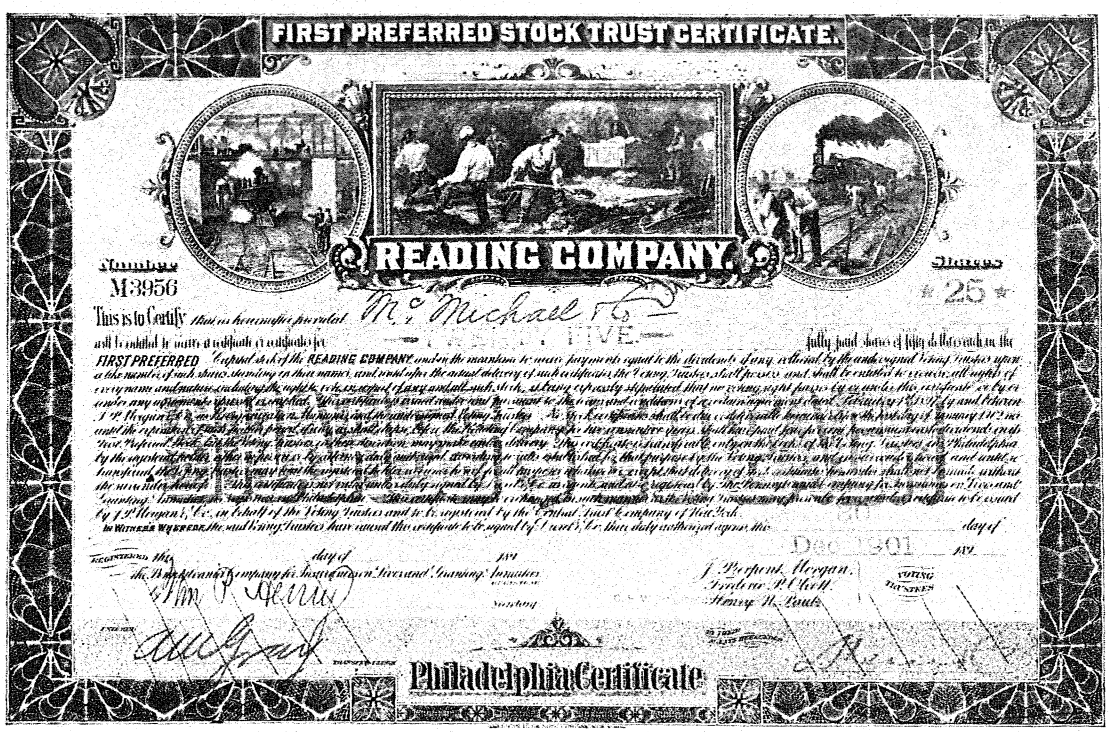
J. D. Rockefeller Prest

common together with the first preferred stockholders are not able to furnish the funds needed, they together may agree to offer for sale another series of shares which shall take precedence over both former issues, and in which the new issue shall stand as first preferred and the others in their former dividend-paying relations. The new preferred, therefore, would have first claim, the old preferred second claim, and the common would have third claim to dividends.

*First preferred and second preferred.*

The conditions of preferment may be such (in case dividends are not declared at a regular time agreed upon and to the amount provided) that the amount of dividend which is "passed," that is, which passes over as not paid, shall "cumulate" and become an additional charge against the amount set apart as dividends to be paid to the preferred stockholder out of future profits before the common stockholders may participate. If no such provision be made in the contract of preferment, however, the stock is "non-cumulative," and a "passed" dividend will be lost to the preferred stock. Under the cumulative feature of preferred stock, it will readily be understood, a number of "passed" dividends may become such an enormous charge upon the future earnings of the company as to render the common stock practically worthless. On the other hand, the "non-cumulative" feature may allow the common stockholders, through their officers, to delay the payment of dividends on preferred until such a surplus has been acquired by the company that the common stockholders may receive much more than their proportionate share of the profits; without a cumulative preferment, the representatives of the common stock may continue to apply the profits to improvements until the industry shall become so highly profitable through added capital that the regular return to the common stock may far exceed that which is fixed for the preferred.

*Cumulative and non-cumulative preferred.*


FIRST PREFERRED STOCK TRUST CERTIFICATE.
READING COMPANY.
Number
M3956
Shares
25
This is to Certify
Mc Michael & Co
FIVE
FIRST PREFERRED
Dec 1901
J. Pierpont Morgan
Frederic P. Olcott
Henry W. Poole
VOTING TRUSTEES
Philadelphia Certificate

*Trust certificate.*

It sometimes happens that a number of stockholders may wish to pool their holdings in a company for purposes of control. To this end the stockholders agreeing will appoint a trustee to hold the stock and exercise all rights of control for them. The trustee gets his powers from a written trust agreement, under which he pays to the several stockholders the dividends declared, and finally delivers the shares after the trust agreement is terminated. When such an arrangement is made the trustee issues to each stockholder depositing his stock a trust certificate. One of the trust certificates issued by J. P. Morgan & Co. as trustee for Reading First Preferred is given on page 107. An examination of the certificate will further explain its use.

*Other forms of stocks.*

Other special forms of stock, such as guaranteed stock, founder's shares, treasury stock, etc., are allowed under the laws of some States. These might be enlarged upon, but for the purposes of this treatise it is sufficient to call attention to the principal proprietary interests which may be sold as a means of obtaining funds for enterprise. We pass now to a consideration of sales of credit.

## CHAPTER VII

### FUNDS OBTAINED BY SALES OF COMMERCIAL CREDIT

THERE are still other ways of obtaining funds by exchange—methods which do not involve the sale of labor, tangible properties, or business interests. If one has salable credit, this may be disposed of to meet the funding needs of business. In Part I credit was discussed as a form of funds. We will now discuss its use as a means of obtaining funds.

*The extent of credit uses by the laboring man.*

Credit is bought and sold in the market in the same manner as are services, or stocks of merchandise. Before a sale of credit may be made, however, one must find a purchaser—some one who is willing to exchange money or credit funds for a promise to deliver money at a future time. In this is found its limitation; it is this that places it beyond the reach of the ordinary laborer as a means of obtaining capital. The day-laborer goes to the man of means (the capitalist), and proposes to give him his promise to pay $110 one year hence for $100 in gold. The man of means says "No." Some such reasoning as this goes on in the capitalist's mind: "You have never been able to do more than maintain yourself." "Yes, it is true you have paid your account at the grocer's; you have kept faith with those who have furnished the means necessary to 'maintenance' on credit, but you have never displayed any ability to acquire 'capital.'" "What surplus earnings you have had were dissipated." "You have not the ability nor the integrity to make your

credit good." In other words, in the judgment of the capitalist, the credit which the laboring man tries to dispose of for capital funds is seldom considered worth as much as the money for which it is offered. The capitalist will not trade.

One with thrifty habits and good training, on the other hand, may meet with greater success. On leaving college you may go to a banker to whom you are known and offer him your note. At first he may be unwilling to buy your credit. You may even have trouble to find a business manager who is willing to buy your services. But eventually you get employment. You demonstrate your ability. You show yourself to be a man capable of performing a service for which employers are willing to pay $1,000 or $2,000 per year. You exhibit some special fitness for the management or direction of some industrial function; perhaps you have invented something, the use of which will be of advantage in production; you demonstrate that you have the power to form judgments of such superior quality that a business dependent on such decision may be handled with increased profits. Now, without capital, with nothing but this ability displayed, and a reputation for habits of industry and integrity, you again approach the man of means and offer your credit for funds with which to capitalize your advantage, and he is willing—even anxious—to exchange. Why is this? Why are you able to procure capital funds "on credit," without awaiting the slow process of saving, while thousands of others are required to depend on the surplus accumulated from wages earned? The answer is plain. The capitalist believes that he is making a good trade. You have something to sell, besides your ability to work for others, which he values more highly than he does the amount of money for which credit is offered—your ability to use capital in such a way that you will be able to deliver the amount obtained "with interest." The man of means sees in the transaction a profit to himself. In exchange for funds sold, he gets a

*The man of ability and integrity.*

claim to future income which, in his judgment, will be to his own advantage.

One possessed of tangible property or business interests has still less difficulty in convincing the capitalist of his ability to meet his contracts for future delivery. He offers to sell credit because he does not care to sell his tangible property or business interests. The property gives a double advantage: by its use a larger income is assured; if this larger income does not suffice, the property is still capable of being sold as a means of obtaining "funds" with which to meet credit contracts. All of this is taken into account by the one to whom the man with property offers to sell his credit.

*The man with property.*

### Credit Instruments used as a Means of obtaining Funds

A promissory note is a *written* contract for the future delivery of a specified sum of money. The contract is similar to that made between speculators in grain or securities known as futures, except that the "note" is for the delivery of money instead of a particular grade of wheat or a particular class of bonds. The delivery must be made on or before a stated time, and nothing will satisfy the contract except the delivery of the particular thing promised.

*Promissory note.*

There is nothing fixed or prescribed about the *form* of the promise; it may be expressed in any way so long as its essentials are present. These essentials will be set forth in detail. Being a contract in writing, the parties must be set forth in the instrument. There must be at least two parties named—the one to whom the promise is made and the one making it. The one making the note is called the *maker*; the one to whom it is made is called the *payee*. The maker usually signs his name under the writing which carries the promise. There may, however, be two or more

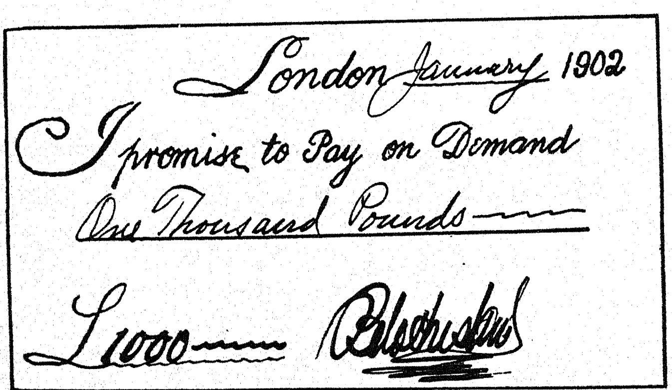
*Form of note.*

*1. As to parties.*

makers of the same note. A note that has two or more makers is called a *joint note.* Joint notes may be made by each individual signing his name individually, or in case several persons are combined in business relations as partners, one of the partners, or one authorized to sign the partnership name, may subscribe the name of the partnership and bind them all. The payee may be the one whose

> JOHNSTOWN, PENNSYLVANIA, June 30, 1900.
>
> Thirty days after date *we jointly* promise to pay to Sylvester Jones, One Thousand Dollars, with interest at the rate of six per cent per annum.
>
> BIRDWELL, SMITH & BROWN,
> by VAUGHAN BROWN.

name is inserted in the note at the time it is made and delivered. Commercial usage, however, has allowed the words "or order" to be added. Such expressions as "Pay to [name


London January 1902

I promise to Pay on Demand

One Thousand Pounds

£1000 [illegible]

of payee] or order," or "Pay to the order of [name of payee]," indicate that the one named may, in writing, direct payment, or delivery, to be made to some one other than himself. Above is a form of note that is defective, for

the reason that no payee is named in the instrument. This defect may be overcome by negotiating the note.

> BALTIMORE, MARYLAND, January 10, 1899.
>
> On the first day of September, 1899, we promise to pay to Martin Lowden, or order, the sum of One Hundred Fifty Dollars, with interest from date at four per cent till paid.
>
> LOUIS SAMPSON.
> J. L. McKENZIE.

2. *Words of transferability.*

The right granted to the payee named, *to order payment to be made to another*, does not make the contract any less certain as to whom payment is to be made, but it gives to the instrument higher value by making it negotiable. Negotiable in the commercial sense means *transferable*; a negotiable note is one which may be transferred from one person to another by such acts or writing as is necessary to give evidence of the right of the person presenting it to receive payment. The insertion of the words "or bearer" instead of "or order" effects the same end. This makes the note negotiable without assignment or indorsement; nothing need be added to it to show title or a right in the one presenting it to receive payment. A note that has no such words as "or order" or

> NEW YORK CITY, July 5, 1900.
>
> One year from date I promise to pay to John P. Larkin, *or bearer*, the sum of Two Hundred Fifty Dollars, gold coin of the United States of present weight and fineness, at the Chemical National Bank.
>
> CHARLES O. PASTORIUS.

"or bearer" added after the name of the payee, but on its face makes the money promised payable to a definite person, is not transferable and is non-negotiable.

*3. As to words of promise.*

The promise clause contains the essence of the agreement, and though it may take any form of expression, the meaning must be an unconditional obligation on the part of the makers to pay a definite sum of money. In case there be more than one maker, the expression "we promise," or "we jointly promise," means that each of the makers agrees to pay a certain proportion of the amount of money named; while "we jointly and severally promise" means that each one of the makers will pay the whole amount if the others fail to pay their proportion. The promise clause may be simply a

> $2,346.$\frac{00}{}$
>
> We *jointly and severally* promise to pay to the United States Trust Company of St. Paul, Minnesota, the sum of Two Thousand Three Hundred and Forty-Six Dollars, on the tenth day of December, 1893, *with interest thereon at the legal rate till paid.*
>
> St. Paul, Minnesota,
> September 10, 1893.
>
> George P. Austin.
> Marshall Mehan.
> Alonzo Porter.

promise to pay an amount stated at a given time. In this case no other amount may be collected at that time. But that part of the contract which contains the promise is usually in two clauses: the one contains a promise to pay a definite amount called the "principal" sum, and the other states a second proportionate sum to be paid as "interest." This later claim is sometimes in words which require a mathematical computation in order to determine the amount due. The principal, however, must always be a fixed sum; otherwise the amount of interest may not be determined, and any uncertainty as to the amount due would destroy its character as a promissory note. Sometimes the additional sum, called "interest," is made the consideration for a separate note, in which case the interest sum appears as a

definitely determined amount. A contract made payable in anything but money is a form of obligation that would be enforced, but it would not be a "promissory note"; it

> $50.00 PEORIA, ILLINOIS, January 27, 1898.
>
> On the 27th day of July, 1898, I promise to pay to Jacob Straussner, or order, the sum of Fifty Dollars, at his office, No. 234 Main Street, with interest at the rate of 6 per cent, after maturity, the same being for an instalment of interest due on that day upon my principal promissory note, of even date herewith, payable to Jacob Straussner, or order, three years after this date for the sum of Two Thousand Dollars ($2,000). L. B. FRENCH.

would not pass as commercial paper. Such contracts are common in the market-place, but they are not usually made negotiable, and would not be called "credit instruments." They are not in any wise treated as such.

*4. As to date of making a note.*

The date of making and issuing a note has a double significance. In the first place, it is the common custom to make a note payable a certain number of days or months after date, though some bankers and business men now consider it better form to draw notes and time drafts payable at a certain time stated in the instrument, as, "On the 10th of March, 1897, I promise to pay." In this case a date of making is not necessary. In the second place, the date of the note may affect its validity. In most Christian countries a note made and issued on Sunday is void. The date of maturity is the day on which a note becomes legally due—the day on which the payee has a right to demand the money promised. The date of maturity can not be left indefinite; no doubt must be left as to the time when demand for payment may be made. In finding the date of maturity it is important to remember that when a note is drawn "*days after*

9

*date*" the actual days must be counted, and when drawn "*months after date*" the time is reckoned by months. At common law a note is not legally due till three days after the expiration of the specified time. These are called "*days of grace*." The party making a note may waive the right to days of grace by express contract in the instrument itself. Some jurisdictions have made this unnecessary by statutory enactment. Where "days of grace" are abolished by statute the note falls due on the day stated in the contract.

> $25.$^{\underline{00}}$ STOKESVILLE, MONTANA, June 20, 1898.
>
> I hereby promise to pay to the Stokesville National Bank the sum of Twenty-Five Dollars, three months from date, interest at one per cent per month, *without grace, the usual three days of grace being hereby specifically waived by me.*
>
> LAWRENCE LOGAN.

*5. As to signature.*

The maker's signature must appear in some form upon some part of a promissory note. It usually appears immediately after the written promise, though it may be placed on any part of the instrument and still bind him to the performance. It need not be affixed by himself, however; signature may be made by any authorized attorney or agent. It may be the full name or only the initials. The usual business signature should be used as a matter of avoiding doubt or question. When a man who can not write is asked to sign a note or other legal instrument, the usual custom is for some one else who can write a legible hand to inscribe his name.

*A "mark" signature.*

This should be so written as to leave space in the written line for a cross. After explaining the nature of the instrument the signer or maker is asked to place a cross in the space left, as shown in the exhibit. Above and below the cross, and in the presence of the signer, is written $\overset{\text{his}}{\underset{\text{mark}}{\times}}$. Such a signature should also be

witnessed. A witness is essential for the reason that the signer may afterward deny that he executed the contract.

his
Charles X Conover
mark

Witness—Jonathan Edwards.

*Non-essential clauses.*

*"Value received."*

Aside from the essential parts, there are various clauses added from custom or local practice that do not affect its validity nor add to its obligations. One of the most frequent of these is the phrase "for value received." Thousands of good notes made without any value consideration stated in the instruments themselves are handled daily. Notes containing this phrase are an old form of written evidence of the credit contract; the newer forms drop this wording.

*"Without defalcation."*

In Pennsylvania the words "without defalcation" are inserted. This is wholly superfluous. "Credit the drawer" is sometimes inserted in the lower left-hand corner with the signature of the payee.

$5000 00/100 Philadelphia, May 29 1902.
Ninety days after date I promise to pay to
the order of myself
Five Thousand 00/100 Dollars
at the Bank of North America
Without defalcation for value received.
Due Aug 27 Louise Kissell

The manner of using such a note is as follows: Leander Jones wishes to borrow $100 from James Thompson.

For this he offers his note for the amount desired. The note is executed in regular form. Instead of Thompson giving to Jones the money, or his check for $100, however, he writes on its face, "Credit the drawer," and indorses it. Jones then takes the note to his bank and exchanges it for a bank account in the same manner as if Thompson had given his check. This form of note is also used to evade the "married woman" clause of the law, which prohibits contracts of surety and indorsement. John Patterson, the husband of Augusta Patterson, wishes to obtain funds on the credit

*"Credit the drawer."*

$300.00 Bethlehem, Pa., August 15th 1901.
Ninety days after date I promise to
Pay to the order of Augusta Patterson at
The First National Bank of Bethlehem.
Three Hundred and no/100 Dollars,
without defalcation for value received
Credit the Drawer
Augusta Patterson
John R Patterson

of his wife. He therefore executes his note to her. She enters on its face, "Credit the drawer," and then indorses it. This allows John to obtain the funds needed by discounting it. Ostensibly John is the maker of the note; in reality it is Augusta that is the responsible party.

Another peculiar use of this form of note is given opposite. A number of parties are commonly interested in raising funds. They arrange for accommodation by co-signature. The names of all the parties who are to sign are entered on a marginal slip, with the understanding that the note will not be complete till all have signed, it being understood that each is to become responsible for a *pro rata* only. The first to sign is understood to be the drawer, while all the others are accommodation signers.

Date..................

Amount, $.............

Time..................

Due...................

Discount...Days...$...

Renewal of $...........

Leonard Grafton.

Hiram Hadley.

Peter McIntyre Brown.

Tyson & Mowbry.

William A. Custard.

L. A. Marks.

Latshaw Grocery Co.

J. B. Samuelson.

E. Browning.

Alonzo Parkinson.

Uriah Lundy.

P. B. Cornlee.

$.....          READING, PENNSYLVANIA.

We, the undersigned, promise to pay to THE GARDEN CITY STEAM PAPER AND BOX MANUFACTURING Co., or order, .... month after date, the sum of ...................... Dollars, without defalcation for value received, at the KEYSTONE NATIONAL BANK of Reading, Pa. It is understood and agreed, however, that the liability of the subscribers hereto is limited in such manner that each shall be obligated only to pay such an amount thereof as is ascertained by dividing the whole amount of the note by the number of subscribers.

[Signed]

CREDIT THE DRAWER.

THE GARDEN CITY STEAM PAPER AND BOX MANUFACTURING CO.

*Treas.* ...............

...............

...............

...............

...............

...............

...............

...............

...............

...............

Renewal of $......

The parts of a note containing contracts of security for payment when due (expressed or implied) are found: (1) In its signatures of accommodation, indorsement, or guarantee—i. e., in contracts for *personal security*. (2) In its special clauses carrying transfers of collateral, powers to enter judgment by confession, without action, rights to levy execution, etc.—i. e., in contracts for *lien security*.

*Parts of note containing contracts of security.*

An accommodation signature is given as security for the payment of a note by one having no interest in the funds obtained by means of the instrument sold. For example, one may apply at a bank for a loan. He offers his note for $105 (principal and interest), due one year hence, in exchange for $100 in cash. The banker refuses to take the note at that price, and the one offering it does not care to sell it for less. He has a friend with him, and the banker offers to give $100 for the note if the friend accompanying him will become an "accommodation signer." His friend agrees, and the trade is made. In form the note is a joint one—in fact, it is "accommodation paper." The maker's friend becomes jointly liable with him for the payment of the note, but his obligation is purely one of "accommodation"—that is, the value of his credit (of his ability and integrity) is added to the principal maker's as security to the banker for the payment of the sum contracted for.

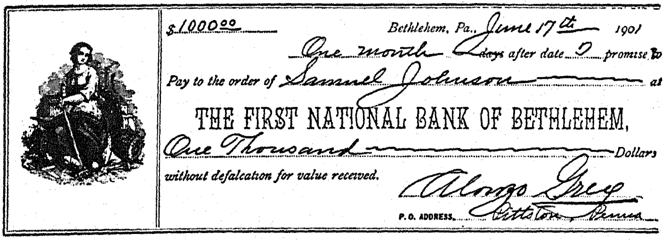
*Personal security.*

*Accommodation signatures.*

Indorsement is another form of contract of security. Samuel Johnson is owner of a note or contract made, whereby Alonzo Grey agrees to deliver $1,000 to the order of Samuel Johnson one month after June 17th. Johnson takes the note to a "commercial paper man" and offers to sell it for $995—i. e., he offers six per cent discount as an inducement to purchase. The dealer, however, does not know Alonzo Grey, and is not willing to purchase his contract to pay without security. He is willing to purchase Johnson's credit, however, at the price

*Indorsement.*

offered. He therefore proposes that he will give the amount asked for the note provided Johnson will indorse it—write his name across the back. When a note is


$1000.00 Bethlehem, Pa., June 17th 1901

One month ~~days~~ after date I promise to

Pay to the order of Samuel Johnson at

THE FIRST NATIONAL BANK OF BETHLEHEM,

One Thousand Dollars

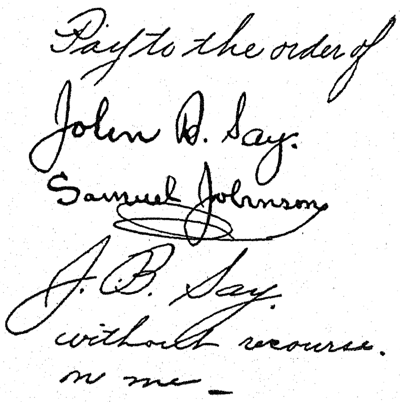
without defalcation for value received.

Alonzo Grey

P.O. ADDRESS, Pittston Penna

made payable "to order," the writing of the name of the payee across the back performs two services. In the first place, this is necessary in order to assign or transfer the right to receive payment; a note which is made payable "to bearer," however, needs no assignment, and indorsement is not necessary for this purpose. In the second place, the "indorsement" is a contract of security—it carries with it an implied promise of the indorser that he will pay the amount promised on the day it is due, if the maker fails to do so. Indorsement is usually made in blank—that is to say, without the words "Pay to the order of." The purchaser of the note is then free to pass it on from hand to hand without further assignment. In such case, further indorsement could be for *security* only. If the owner of a note wishes simply to assign it—that is, to transfer the right

*Without recourse.*


Pay to the order of

John B. Say.

Samuel Johnson

J. B. Say.

without recourse

on me

to receive payment from the maker, without also becoming responsible for the fulfilment of the promise—this may be done by adding the words "without recourse." The effect of this is to deprive the indorsement of its character as security. Release from liability on contract of indorsement after it is made may be by separate agreement.

One may guarantee the payment of a note without indorsing it—i. e., by entering into an additional written contract. If there has been any advantage gained, any new consideration passed at the time such guarantee is made, the contract will be valid and the guarantor may be held for its payment. Without consideration the guarantee is void. The guarantee is usually in form of a separate writing and not made upon the note itself.

*Guarantee of note.*

Louis Ryerson

I hereby guarantee the payment of both principal and interest of this note and agree to pay the same if not paid on or before Sept. 1. 1900.

Robert Morris

September 23, 1898

*FOR VALUE RECEIVED,* ............ *hereby guarantee the prompt payment, at maturity, of the following described note , executed under seal —*

______________________________

______________________________

______________________________

______________________________

______________________________

______________________________

*and endorsed by* ______ *; and hold* ____________ *bound by this guarantee and endorsement, the same as though such note were not executed under seal.*

______________________ *189*          ______________________

It often happens that it is of mutual advantage to pledge "collateral securities" (stocks, bonds, or mortgages) for the

payment of a loan instead of asking personal security or executing a mortgage. This is done by offering a regular promissory note, to which a contract is added setting forth the "securities" delivered and the conditions attached to their delivery. The one granting the loan will hold these securities subject to the agreement. In case the contract for payment is not fulfilled, the contract of security may be relied on and strictly

*Collateral note.*

PHILADELPHIA, June 1 1902

*On demand* I *promise to pay to the Order of*

BROWN BROTHERS & CO.,

Fifteen Thousand Dollars

WITH INTEREST FROM DATE, for value received, without defalcation, hereby waiving all right to stay of execution and exemption of property in any suit on this note.

As collateral security I have delivered Ten shares U. S. Steel Corp. common Ten shares U.S. steel corp. preferred, and sixty shares Penna. RR.

which I hereby authorize and empower the holders hereof, on default in payment at maturity, with a view to its liquidation, and of all interests and costs thereon, to sell and transfer, in whole or in part, without any previous demand upon or notice to me, either at Brokers' Board or at public or private sale, with the right of becoming the purchaser and absolute owner thereof, free of all trusts and claims, should such sale be made at Brokers' Board or be public. Furthermore, I agree, that so often as the market price of these and subsequently-deposited securities shall, before maturity of this note fall to a price insufficient to cover its amount, with ten per cent. margin added thereto, I will, on demand within two hours thereafter, deposit with the holders additional security, to be approved by said holders, sufficient to cover said amount and margin; and that, in default thereof, this note shall become instantly due and payable precisely as though it had actually matured, and all the foregoing rights to sell and transfer collaterals shall at once be exercisable, at my risk, in case of any deficiency in realizing proceeds. And I further agree that the securities hereby pledged, together with any that may be pledged hereafter, shall be applicable in like manner to secure the payment of any past or of any future obligations, held by the holders of this obligation, and all of my securities in their hands shall stand as one general continuing collateral security for the whole of my obligations, so that the deficiency on any one shall be made good from the collaterals for the rest.

John Jacob Astor Berdon

enforced. These contracts of collateral lien security have many forms. The one above given, it will be noticed, authorizes and empowers "the holder of this promissory note (provided the same is not paid at maturity) to sell at auction or private sale, and transfer, without further reference or notice," to the maker of the note, "and apply the proceeds in payment" of the note, "together with interest charges incurred thereon." Provision is also made for the disposition of the surplus. This contract, together with the property on which it constitutes a lien, serves as security to the purchaser of the credit promise and thereby increases its value. It enables the seller of credit to obtain a higher price for it in the market.

*Memorandum collateral note.*

The accompanying form of note was largely used by banks making call-loans to customers during the time that the stamp revenue act was in force. It was thought to contain no promise, therefore to avoid the necessity of paying the stamp-tax imposed on promissory notes. In form it is simply a memorandum made by the cashier to the effect that the bank had advanced

**The Bank, Pa.**

Has this ____________ day of ____________ advanced to ____________ the sum of ____________ ____________ Dollars, collaterally secured, being entitled to demand a return of the said amount, with interest at the rate of ______ per cent. per annum, on demand. Collaterals deposited herewith listed on back of this note.

____________ *Cashier.*

*Correct:*

a certain amount of funds to the customer for which certain collateral had been deposited. The memorandum was then marked "O. K." or "Correct" by the customer over his signature. This constituted an "account settled," and was enforceable at law as an instrument of collection. Had the revenue officers brought this form of instrument before

the courts it is highly probable that for the purposes of the act it would have been declared an evasion of the tax.

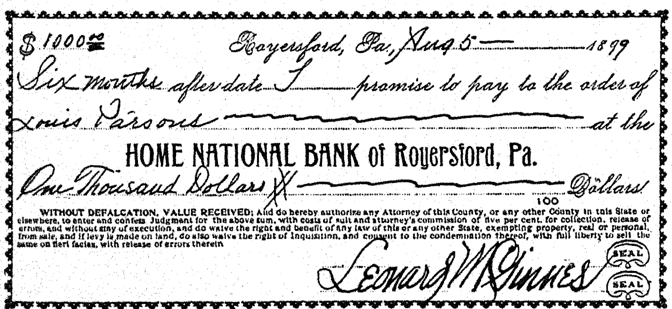
*Judgment note.*

Added to the ordinary form of note of promise for the future delivery of money is often found a clause in the nature of a confession of judgment for the principal amount, with interest, and cost of suit.

> $250.00. JACKSBORO, TENNESSEE, May 1, 1897.
>
> One year after date, for value received, I promise to pay to Jonas Greer, or bearer, Two Hundred Fifty Dollars, with interest, without defalcation or stay of judgment. And I do hereby confess judgment for the above sum, with interest and cost of suit, a release of all errors and waiver of all rights to inquisition and appeal, and to the benefit of all laws exempting property, real or personal, from levy and sale.
>
> PETER VAN DYKE.

*Judgment note with power of attorney.*

Another form of judgment note is one authorizing some one to act as attorney for the maker—to appear and confess judgment for the amount due in case of default. The effect of this contract is to allow the holder, at any time after the note is due, to enter judgment and to seize upon any property of the debtor by process of execution, thus securing a lien upon any and all property found that may be



$1000 00/100 Royersford, Pa., Aug 5 1899

Six months after date I promise to pay to the order of Louis Parsons at the

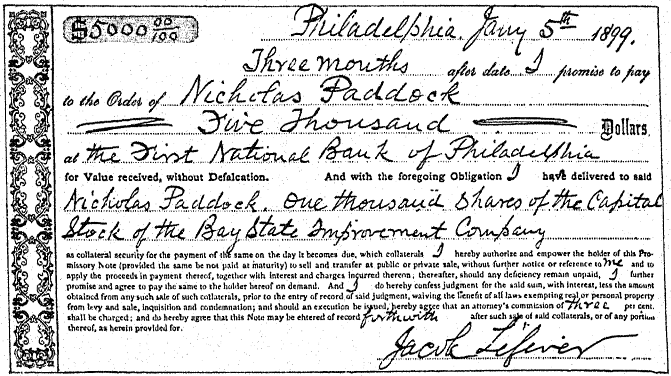
HOME NATIONAL BANK of Royersford, Pa.

One Thousand Dollars xx/100 Dollars

WITHOUT DEFALCATION. VALUE RECEIVED; And do hereby authorize any Attorney of this County, or any other County in this State or elsewhere, to enter and confess Judgment for the above sum, with costs of suit and attorney's commission of five per cent. for collection, release of errors, and without stay of execution, and do waive the right and benefit of any law of this or any other State, exempting property, real or personal, from sale, and if levy is made on land, do also waive the right of Inquisition, and consent to the condemnation thereof, with full liberty to sell the same on fieri facias, with release of errors therein

Leonard McGinnes SEAL SEAL

necessary to satisfy the amount of the contract. It is a very severe form of agreement by way of security, and some States on this account have made it illegal for reasons of public policy. The following form is unusual in that it combines a contract of collateral security with one giving power to enter judgment without action for any deficiency on sale of collateral.



$5000 00/100 Philadelphia, Jany 5th 1899.

Three months after date I promise to pay to the Order of Nicholas Paddock

Five Thousand Dollars,

at the First National Bank of Philadelphia

for Value received, without Defalcation. And with the foregoing Obligation I have delivered to said Nicholas Paddock, One thousand Shares of the Capital Stock of the Bay State Improvement Company

as collateral security for the payment of the same on the day it becomes due, which collaterals I hereby authorize and empower the holder of this Promissory Note (provided the same be not paid at maturity) to sell and transfer at public or private sale, without further notice or reference to me and to apply the proceeds in payment thereof, together with interest and charges incurred thereon; thereafter, should any deficiency remain unpaid, I further promise and agree to pay the same to the holder hereof on demand. And I do hereby confess judgment for the said sum, with interest, less the amount obtained from any such sale of such collaterals, prior to the entry of record of said judgment, waiving the benefit of all laws exempting real or personal property from levy and sale, inquisition and condemnation; and should an execution be issued, hereby agree that an attorney's commission of three per cent. shall be charged; and do hereby agree that this Note may be entered of record forthwith after such sale of said collaterals, or of any portion thereof, as herein provided for.

Jack Lefevier

A promissory note performs a double purpose as a funding instrument: (1) It is a form of instrument which allows the maker of the note to dispose of his credit in exchange for funds. (2) As a contract for the future delivery it is an instrument in the hands of the holder by means of which he may obtain funds through sale or through *payment* (the delivery of the funds promised). It is this second use that we still have to consider. Payment is obtained through presentation, and depends as much on the punctuality of the holder as on the punctuality of the maker. A note should be presented on the exact day of maturity. When made payable at a bank, or at any other place, notes must be presented for payment at the place named. If no place is specified, a note should be presented at the maker's place of business or at his residence. The fact that a note is not presented on the day of maturity does not affect the obli-

*Presentation for payment.*

gation as between maker and payee; but unless there is an express waiver of rights, the note must be presented upon the exact day of maturity if the indorsers and guarantors are to be held liable under these contracts.

*Part payment.*

A maker may usually pay a part of his obligation before it is due. It often happens that it is not convenient to pay the whole amount when due, in which case the holder may take a part and grant an extension of time on the balance. This is in reality a new contract. If a part payment is made, such payment should be indorsed on the back of the note. Indorsement of this kind requires no signature; the usual form is, "Received on within note," stating the amount and date of payment. An ordinary separate receipt does not give notice to a purchaser that a payment has been made. A receipt indorsed on the back reduces the face of the note. Only payment of the obligation in full—i. e., payment of the exact amount of money promised—will satisfy its conditions, unless the payee enters into a new contract whereby he agrees to accept something else in place of the money. For example, suppose the maker's check were accepted. Usually, acceptance of a check and the surrender of the note constitutes a new agreement whereby the payee relinquishes his right to receive the amount of money promised; the consideration for the relinquishment or cancelation of the contract is an order on the bank to transfer funds from the account of the maker of the check to the one surrendering the note. Such a settlement is what is called an "accord and satisfaction" between the parties.

*Legal tender.*

If there is a controversy as to the amount to be paid, the maker may offer (i. e., he may make a tender of) such an amount of money as he may think due. If this is refused, and a court to whom the controversy is referred decides that the correct amount of money has been tendered, the maker will be entirely released. If, again, the dispute be with regard to

the kind of money offered, the maker need only offer that which by law is made "legal tender" for the payment of debts. In the United States gold and silver coins of the United States and greenbacks are "legal-tender" money for the satisfaction of credit contracts, unless some other kind of money is specified in the agreement; in such case, the kind promised must be delivered if the creditor insists.

*Non-payment of note.*

It often happens that there is a failure and refusal on the part of the maker to meet his promises. He may have refused payment because he was unable to secure the necessary funds; he may dispute the amount claimed on the ground of failure on the part of the payee to indorse a part payment already made, or for some other reason; he may seek to avoid his debt. In any case, the fact of failure and refusal gives to the payee a "right of action" in the courts not only against the maker, but also against all "cosigners," "indorsers," and "guarantors," to compel them to make payment of the money promised and for which they became surety.

NEW YORK, ............ 189 .

To ......................

You are hereby notified that a certain note made by .......................... for $..................
in favor of .........................................
dated ................, and by you indorsed (or guaranteed), was this day presented to .....................
for payment and payment was refused.

[Signed] ..................

*Notice of non-payment.*

The holder of a note which has been indorsed, or the payment of which has been guaranteed, must notify the indorser or guarantor if payment is not made when due. When one becomes surety for the fulfilment of another's credit contract, he is entitled to know of the non-payment in order that he may

take steps to protect himself. If he receives no notice of non-payment he has a right to presume that the contract has been met and that he is released from the security. On page 128 is the usual form of written notice sent.

*Waiver of demand and notice.*

This right to have demand made on the day that the note is due and to notice of non-payment, however, may be waived by indorsers and guarantors at the time the contract is entered into. "Call-loan" notes and many of the "short-time" notes taken by banks very commonly have a clause in the instrument of this kind. The law simply protects the indorser in case he does not sign away his rights. When waiver is made the contract may be strictly enforced by a *bona-fide* holder.

$500. LOGANSPORT, INDIANA, June 30, 1897.

We, or either of us, promise to pay to the order of John Hartwell Bates, on July 30, 1897, the sum of Five Hundred Dollars, with interest at the rate of 6% from date, for value received.

And the cosignors and guarantors of the above note hereby severally and specifically waive all rights and exemptions that would accrue, for failure of the holder to present this note for payment when due, for notice of non-payment, notice of protest and of demand upon them for payments, in case this waiver and exemption had not been specifically made.

LOUIS STRANGER.
PETER LONGFELLOW.
JOHN R. CRANDALL.

*Protest.*

An indorsed or guaranteed note which is presented for payment outside of the jurisdiction in which it is made, and is not paid, is usually *protested*; this is done to give formal evidence that the note was presented for payment and that payment was refused. *Protest* is a formal declaration made by a notary public into whose

hands a note has been placed for official and formal presentation, together with a formal record of the fact by the notary. The notary usually attaches the certificate of protest to the note; he may also mark upon the face of the note the fact of its dishonor. When a note is sent to a bank or other agent for presentation and collection, the greatest precaution must be taken before protest; the bank

$1000.00 Bethlehem, Pa., June 17th 1901

One Month ~~days~~ after date I promise to

Pay to the order of Samuel Johnson at

THE FIRST NATIONAL BANK OF BETHLEHEM.

One Thousand Dollars,

without defalcation for value received. Alonzo Grey

P. O. ADDRESS, Allentown, Penna

P. P. JULY 17, 1901.
NOTARY PUBLIC FEES, 1.60

or other agent should never have it put into the hands of a notary for official presentation and protest until it is made certain that the non-payment has not occurred through mistake; usually a messenger will be sent out with the note

PHILADELPHIA, July 17th 1901

MY Samuel Johnson

At the request of the Holder,

**The Centennial National Bank**

I, the undersigned, **Notary Public for the Commonwealth of Penna.** have this day protested a Note for $1000. dated June 17 1901, drawn by Alonzo Grey (the same being due, demanded and refused), and you as endorser. will be looked to for payment, of which you hereby have notice.

**D. S. LINDSAY, Real Estate Broker,**
**No. 14 South Broad Street**

☞Please notify the other parties

to the maker to make formal demand before turning it over to a notary, even though the note is made payable at the

bank. For self-protection, banks make it a rule to protest all paper received from another State for collection which is not paid when due, unless ordered not to do so by the

D. S. LINDSAY, { NOTARY PUB C, REAL EST.,TE ROKER, } No. 14 South Broad Street, Rothschild Building.

**United States of America.**

(COPY)

$1000 00/100 Bethlehem Pa June 17th 1901

One month after date I promise to pay to the order of Samuel Johnson at — The First National Bank of Bethlehem One Thousand Dollars without defalcation for value received

Alonzo Grey

P.O. Address. Pittston. Penna

END. Samuel Johnson

*BE IT KNOWN*, That on the day of the date hereof, at the request of THE CENTENNIAL NAT. BANK, the holder of the original note, of which a true copy is above written, I, the undersigned, *Notary Public for the Commonwealth of Pennsylvania*, by lawful authority duly commissioned by the Governor of Penna., and sworn, residing in the City of Philadelphia, during the usual hours of business for such purposes, caused the same to be presented at The First National Bank of Bethlehem and demand made for the payment thereof, which was refused and answer made

"Not sufficient funds"

Whereupon, I, the said Notary, at the request aforesaid, ***have Protested***, and do hereby solemnly ***Protest***, against all persons and every party concerned therein, whether as Maker, Drawer, Drawee, Acceptor, Payer, Endorser, Guarantee, Surety, or otherwise howsoever against whom it is proper to protest, for all Exchange, Re-exchange, Costs, Damages and Interest suffered and to be suffered for want of payment thereof:—Of which demand and refusal I have duly notified the parties interested.

notice by mail to Samuel Johnson by mail

*Thus done and Protested* at the City of Philadelphia, the 17th day of July 1901

D. S. LINDSAY NOTARY PUBLIC

D. S. Lindsay,
*Notary Public.*

owner; one wishing not to have protest made should instruct the bank to that effect. Such instructions are commonly attached to the left end of a note-form, with the in-

10

junction that the instruction is to be clipped off before presentation.

*Notice of protest.*

It will be observed that the notice of protest is sent out by the notary public, to the maker of the note and to each of its indorsers and guarantors, making formal and official demand. The form of notice used in Pennsylvania is given on page 131.

*Advantages and disadvantages of using promissory notes.*

All forms of credit are contracts for the future delivery of money which have been "sold" or exchanged for something else of value. That which is received in exchange or "paid" for a credit contract is called the "consideration" or price. A promissory note, as a form of credit contract, has the advantage of being a formal agreement expressed in writing and signed by the party making it, as well as by the ones indorsing or guaranteeing it. It is therefore less likely to be disputed, and more likely to be complied with than is a simple verbal promise, for which there is no written evidence, or a memorandum of account made by the creditor and not signed by the promisor. Being a written agreement also, it may be protested; such public dishonor is likely to injure the credit of the maker and cause his future offers of credit to be less salable; on this account the maker will usually be more prompt. The disadvantages of a promissory note are found in the fact that delivery may not be enforced till the note is due. The only way that the holder can obtain funds on a note not due is to sell it again. When it does come due the maker of the contract may have sold everything that he owns and thus have defeated the enforcement of the contract. An open account, on the other hand, is due at any time. An overdue note (although dishonored) may be a better form of paper for the holder to obtain funds with than a note not due, because action for collection on an overdue note may be begun at once. But a note that has been acquired after it is due is not a safe investment; the one holding it can not raise

the plea of "innocent purchaser" against any defense which the maker might have raised against the payee if it had remained in his hands. Suppose, for example, that the maker had made part payment, and the holder, failing to indorse the amount, sold it after maturity without knowledge on the part of the purchaser that a part of the amount had been paid. In such case the maker would be allowed to set up the payment as a defense in liquidation of the amount.

### Instruments for the Collection of Credit Accounts

The commercial account has already been discussed in its character as *funds*—i. e., as a form of credit used for the purpose of making purchases and payments. The promissory note, on the other hand, has been treated as a form of credit used to obtain funds. Both are evidences of contracts for the future delivery of money. The first contract, however, is one for which there is no evidence except the memoranda or memory of the parties, while the second is evidenced by a writing setting out the contract in full, signed by the party obligated. The promissory note, therefore, as has already been observed, serves a double purpose: (1) by its original sale the maker was able to obtain funds for his immediate use; and (2) the note being a signed and formally executed statement, it may be presented to the maker for payment; it thereby saves the payee for funding purposes by resale or by collection under the contract when it comes due. To restate the difference: The commercial account has for its end the purpose of serving its maker as "funds"—as means of purchase or payment; the promissory note performs the double service of obtaining funds for present use for its maker, and that of obtaining funds for future use for the payee. The commercial account, however, being a contract for the future delivery of money, must have some form of expression of this side of the agreement. There is no written evidence of the contract for payment or future delivery. In exchange for it

goods are given; how will the one who has given goods for this form of credit obtain money in payment under the contract? This has given rise to a whole class of *instruments of collection.*

*Accounts stated.*

The most common instrument of collection is the *account stated.* This is simply a copy of the memorandum, or a statement from memory, of the items of credit and amount received in exchange. This statement is presented to the purchaser for payment. It thus becomes an instrument in the hands of the one receiving the credit, which is used to obtain funds in payment of the credit given in exchange and for which there is no other evidence. After an "account stated" has been presented for payment, if no objection is made to the items of credit contained in it, it is taken for granted that the party receiving the statement accepts it as correct.

Mr. JOSEPH GRAYSON NEW YORK, July 1, 1897.
To JOHN R. BLACK,
Dealer in Boots, Shoes, and Gents' Furnishings. *Dr.*

| | | | | |
|---|---|---|---|---|
| 1897. | | | | |
| June | 2 | One pair boys' shoes......... | $1 | 00 |
| " | 2 | One pair "Rex" tan boots.... | 5 | 00 |
| " | 2 | Two neckties............... | 1 | 50 |
| " | 11 | 1 Monarch shirt............. | 1 | 00 |
| " | 11 | 2 pairs black hose........... | | 50 |
| " | 28 | 1 pair trousers.............. | 8 | 00 |
| | | Total, June account..... | $17 | 00 |

In the above exhibit is a copy of memoranda taken by John R. Black in regular course of business with Mr. Joseph Grayson. The "account stated," or copy of his memorandum, shows that on June 2 Mr. Black received $1 of Mr. Grayson's credit for a pair of boys' shoes,

$5 of his credit for a pair of "Rex" tan boots, $1.50 of his credit for two neckties, etc. During the month he had received, according to his own account, $17 of Mr. Grayson's credit in exchange for goods. He now "states" the account to Mr. Grayson—i. e., presents a copy of memoranda to him for payment.

*Accounts settled.*

The fact that accounts stated are simply the memoranda of one party to the transaction leaves room for question as to their accuracy. For example, Mr. Grayson may deny that he gave $8 of his credit for the trousers purchased on June 28; he disputes the account, claiming that he agreed to pay only $7.50. Mr. Black's clerk may recognize the mistake and correct the error, thereby reducing the account stated to $16.50. But Mr. Grayson prefers to have the account stand over for another month before payment of the amount acknowledged to be due. To place the account stated beyond future controversy, and to show that the amount due has been settled or agreed on, Mr. Grayson marks on the face of the statement "O. K.," adding his initials "J. G." Now the "account stated" takes the form of a written contract for payment of $16.50. At the beginning of the next month Mr. Black renders a new statement of account, in which he enters the amount agreed on as balance due as "balance as per account stated," adding the amounts of credit purchases subsequent to July 1. In

Mr. JOSEPH GRAYSON NEW YORK, August 1, 1897.
TO JOHN R. BLACK,
Dealer in Boots, Shoes, and Gents' Furnishings. *Dr.*

| | | | | |
|---|---|---|---|---|
| July | 1 | Balance as per account stated. | $16 | 50 |
| " | 14 | 1 suit of clothes............ | 30 | 00 |
| " | 14 | 1 Knox hat................ | 5 | 00 |
| | | Amount due August 1... | $51 | 50 |

order to place an account beyond question, and at the same time to have it in form of a "settled account," bills may be rendered at the time the purchase is made or long before the account is due; the party receiving it will go over the items for the purpose of correction, and then return the memorandum with a statement that it is correct, or with "O. K." marked on its face over the signature of the one buying on credit. The account is then in form for collection when due the same as a promissory note.

PLEASE REMIT TO
STUART WOOD, Treasurer,
*Box 4040, Station B.*

No. 500 Philadelphia, January 1, 1901

Mr William Gladstone
Hawarden Castle, Chester, Eng.

TO The American Academy of Political and Social Science, DR.

For Annual Dues for year ending December 31, 1901, $5.00.

Received payment, .................................... 19

.................................................................... *Treasurer.*

Accounts may be paid by the tender of the amount of money due, or by offer and acceptance of something else, as, for example, the acceptance of a "set-off," a "draft" for the amount, a "check," or a "due-bill." The payment is very commonly evidenced by a "receipt," or a written statement of the fact of payment received.

*Accounts paid.*

If one has a claim against another who also has a claim against him, this claim is called a *set-off*—that is, something to *set* or cancel off part of his claim. Under ordinary conditions it is impossible to have a set-off against a note not in the hands of the original payee, but with mutual accounts it is the common method of payment.

*A set-off.*

A due-bill is a written acknowledgment or evidence of a due account. The ordinary form of due-bill is not negotiable, as it is not made payable "to order." It differs from a promissory note in another particular, viz., that it may be made payable in merchandise.

*Due-bills.*

$51.50. NEW YORK, August 1, 1897.

Upon settlement of account, this day, with John R. Black, I acknowledge the sum of Fifty-One Dollars $\frac{50}{100}$ to be due and owing to him by me.

JOSEPH GRAYSON.

*Commercial drafts.*

A commercial draft is an instrument for the collection of funds, through a third party, due on account. It is in the form of a letter from the person to whom an account is due, directed to the party owing an account, requesting him to pay the amount of the draft to a third person and to charge the same to the account of the writer. For example: one Jacob Ross has purchased from William Jones $500 worth of merchandise on account, to be paid on November 1, 1898. On October 30, Lawrence Williams presents an "account stated" to William Jones for $300, and demands payment. Jones has not the money, but tells Williams that Ross is owing him $500 due on November 1. Williams thereupon offers to take a draft on Ross for $300 in payment of Jones's account to himself (Williams), which is agreed to by Jones. He thereupon writes to Ross as follows:

SPRINGFIELD, MASSACHUSETTS, October 30, 1898.

TO JACOB ROSS:

After November 1, please pay to Lawrence Williams Three Hundred Dollars, and charge to the account of

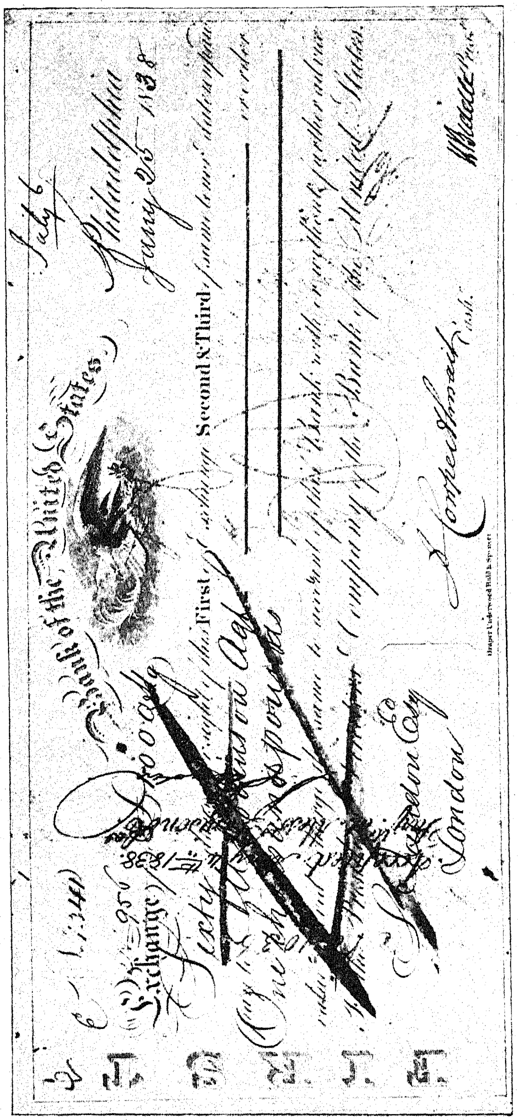
$300.00 WILLIAM JONES.

Upon the receipt of this letter, Williams "receipts" the account against Jones. He presents the draft to Ross and receives payment; Ross charges the amount to Jones's account. It will appear from this that the draft on Ross not only serves Williams as an instrument of collection of

his account against Jones, but it also serves Jones as funds for the payment of his account to Williams. This double relation is always found in a draft. It is primarily an instrument for the collection of funds in the hands of the one receiving it, but it serves the party making the draft as funds for the purpose of payment "on account." It often happens that a party living, let us say, in Boston, owes another party in New York. The New York party, wishing to collect the amount due on account from the Boston man, will "draw on him" through his bank. The bank's correspondent in Boston will present the draft, upon the payment of which the amount will be placed to the account of the drawer. The New York man will be considered as having made a payment to his bank "on account" by drawing on the Boston customer who owes him.

*Foreign bills.*

When a bill or draft is drawn on some one living in a foreign country, it is usually drawn in duplicate or triplicate, so that in case one is lost the other will reach the party to whom it is addressed. This grows out of the increased uncertainty of delivery of a foreign bill. In the foreign bill, more clearly than any other, appears the true nature of the instrument. Primarily, it is a simple request. It is not, when drawn, a credit instrument. Several requests may be made at the same time for the same funds. No promise or contract for the delivery of money may be found in a draft before it is presented. The whole credit quality of a bill depends on "acceptance"—i. e., on the undertaking of the one of whom the request is made to make payment to the party presenting it. The accompanying exhibit is the "First" of exchange, drawn by the Bank of the United States, January 25, 1838. This was one of three bills of like "tenor and date," each bearing on its face the stamp of its relation and significance. On the left end of the exhibit is engraved "First." Each of the other two had engraved upon it "Second" and "Third," respectively. The Bank of the United States, through


Bank of the United States
First
Second & Third

its President, Nicholas Biddle, and its cashier, J. Cowperthwait, issued three bills requesting S. Laudon, of London, to pay to M. Robinson £1,000, and charge the same to the account of the drawer. This payment was requested "sixty days after sight" of the bill first presented. The "First" was presented on May 4, nearly three months after the three bills were drawn. During all of this time there had been no obligation on the part of Laudon, of London, to pay the amount. On that day, however, he

"sighted" the "First," and wrote on its face his acceptance —i. e., S. Laudon undertook to pay £1,000 to the one presenting it sixty days hence. The bill at that moment, and not till then, became a credit instrument—a promise to pay a definite sum of money at a definite time. The "first" request having been honored, the acceptance of either the "second" or the "third" would have been at the risk of the acceptor and not of the drawer, as the request was for the payment of £1,000 only and not for £3,000.

*Sight-bills and drafts.*

A sight-draft is one requesting payment at the time that it is presented. Let us suppose that Louis Borg had an account against Patterson & Co., of Philadelphia. He wishes to pay an account to Peter Sterling for $500. He draws on Patterson & Co. for the amount payable "at sight." A time-draft is one made payable on a certain day, as, for example, "on November 1," or a certain length of time after presentation for acceptance. It is very common to make a draft payable ten days, or thirty days, "after sight." The time of payment of the draft is usually governed by the conditions of payment of the account for the collection of which it is drawn. If a bill of goods were payable ten days after delivery, then a draft might be drawn and sent at the time that the goods were sent, to be presented for acceptance on delivery of the goods, but not payable till ten days afterward.

> $500. PITTSBURG, PENNSYLVANIA, January 23, 1899.
>
> At sight pay to the order of Peter Sterling Five Hundred Dollars, value received, and charge to the account of
>
> To Messrs. PATTERSON & Co., LOUIS BORG.
> Philadelphia.

*Time-draft.*

The acceptance of a draft, like the "O. K." of an account, makes it a written evidence of debt against the one accepting it; it is then in the nature of a promissory note,

to which the drawer becomes the indorser, and the acceptor is the principal party to the contract. Acceptance is made by writing across the face the word "Accepted," together with the name of the party accepting. It is usually dated, and very often the place where payment will be made is added. If the place of payment is not entered, it is payable, like a promissory note, at the office of the acceptor. When the one on whom the draft is drawn accepts it, he is said to "honor" it. If not accepted or paid, it is not more binding on him than a letter or oral request would be. His refusal to honor drafts made for the payment of accounts due, however, will injure his credit in the community—i. e., make it less salable in the future—and thereby will handicap him in using credit as capital in his business.

*Security for acceptance and payment of drafts.*

A draft, before acceptance, is much like a promissory note that has been negotiated before it is executed. It is taken by the payee, or his assignee, on the faith or judgment that it will be accepted. This judgment is based on the contract, or contracts, of security that go with and are attached to or made a part of the bill at the time that it is drawn. As in the case of the promissory note, the contracts of security are of two kinds, viz., (1) personal security and (2) lien security. Unlike the promissory note, however, the contracts of security are for both *acceptance* and for *payment*. In the first place, the drawer enters into a contract (not written, but understood and enforced by law) at the time that the bill is drawn by which he guarantees that the drawer will both accept it and pay the amount when due. To this may be added still other personal security by "indorsement" or "guarantee." But since the bill is negotiated and enters the channels of trade before the credit contract has been executed, since it is offered for discount and exchange in a foreign land, personal security may not be considered sufficient. A foreign exchange house will usually require that collateral or lien security be added to the con-

tracts of personal securities. These collateral contracts may be offered as security for acceptance only, or, as in case of "sight-drafts," for both "acceptance" and "payment."

Baldwin Locomotive Works.

DUPLICATE. Philadelphia, April 26th, 1902.

Peruvian Corporation Ltd. ( F.C. de Guaqui á La Paz.

George Burnham.
William P. Henszey.
John H. Converse.
William L. Austin.
Samuel M. Vauclain.
Alba B. Johnson.
George Burnham, Jr.

To Burnham, Williams & Co. Dr.

Class 8-20 D 105.

| | |
|---|---|
| 50 Charcoal iron boiler tubes $1\frac{1}{2}$" X 100" No. 12. wire gauge, swaged and copper rings one end. | 100 00 |
| 2 Steam pipes finished. | 13 00 |
| 1 Set (5) cleaning plugs. | 12 00 |
| 1 Set (2) fusible plugs. | 1 00 |
| 1 Set (2) front cylinder heads finished. Carried Ford | 13 00 |

A draft thus secured is called a "documented bill." The exhibit here offered is of such a bill "secured of ex-

No. ........

**Shipped,** in apparent good order and condition, by Burnham Williams & Co on board of the **PANAMA RAIL ROAD** Steamer Orizaba ........ or any of the Company's Steamers, or Steamer employed by said Company, now lying in the **Port of New York,** and bound for **Colon, U. S. C.**—To say

Six (6) boxes Machinery
Six (6) tires
Three (3) pairs wheels Gross Wt 6011

Marked F C C de P.
Mollendo via Panama #1/15

(Contents unknown), and being marked as per margin, to be carried upon said **Steamer** or Steamers employed by said Company, (with leave to tow and assist vessels in distress; to sail with or without Pilots; to tranship to any other of said Company's **Steamers,** or Steamer employed by or connected with them, to lighter from **Steamer** to **Steamer,** and from **Steamer** to shore, and to touch at Port or Ports), unto the **Port of Colon** (the restraints of governments, acts of God, enemies, sweating, heat of holds, vermin, rain or spray, nor barratry, fire at sea or in port, disasters or dangers of the seas, or of sail or steam navigation, of what nature or kind soever excepted); there to be delivered to the Agent of the **PANAMA RAILROAD COMPANY,** for transportation to the **Port of Panama,** and from thence (being lightered at the risk of shippers) by Steamer or Steamers of the **PACIFIC STEAM NAVIGATION COMPANY,** and or **SOUTH AMERICAN STEAMSHIP COMPANY** or Steamer employed by either of the said Companies, with the like exceptions, privileges and exemptions unto the Port of Mollendo, Peru and there in like apparent good order and condition, to be delivered unto Peruvian Corporation Ltd. or his or their assigns, *freight for the same at rates as per margin, to be paid in New York in* **United States Gold Coin.**

Said freight to be considered as earned, vessel or cargo lost or not lost; and on the happening of any of the above-excepted contingencies, the said Steamship Companies are to have the right to forward the above-mentioned packages to the ports of destination on their own routes and shall receive extra compensation for such service, whether performed by their own vessels or those of strangers; and in case of salvage services rendered to aforesaid merchandise or treasure, during the voyage, by vessel or vessels of said Companies, such salvage service shall be *paid for as fully as if such salving vessel or vessels belong to strangers.*

It is expressly understood that the articles named in this **Bill of Lading** shall be taken from alongside (at ship's tackles or gangways) by the *consignee immediately after the vessel is ready to discharge, or otherwise they may be landed at the expense and risk of the owner,* shipper or consignee.

These Companies will not be responsible *for* **ANY DAMAGES** *to goods in* **BALES.**

**BUTTER, LARD, OILS, TALLOW, &c.**—The Companies mentioned in this **Bill of Lading** will not be responsible for loss in weight, by leakage or damage *incident to the transportation of Butter, Lard, Oils and Tallow, &c., or similar goods in Steamers and through tropical climates.*

It is expressly understood that the **Companies** *mentioned in this* **Bill of Lading** are not accountable for weight, leakage, breakage, shrinkage, rust, loss or damage from insecurity of packages, inaccuracy or omission in marks or descriptions, effects of climate or decay, sweating, heat of holds, vermin, rain or spray, nor for articles perishable in their nature, or from unavoidable detention or delay, and these Companies will not become liable for any value exceeding one hundred dollars ($100.) upon each of the above-named packages, unless the value exceeds that amount and is so expressed in this Bill of Lading.

It is expressly stipulated that a delivery on the wharf at the **Port of Panama,** of the goods and merchandise mentioned in this **Bill of Lading,** according to the terms thereof, to the **PACIFIC STEAM NAVIGATION COMPANY,** and or **SOUTH AMERICAN STEAMSHIP COMPANY,** shall absolve the **PANAMA RAIL ROAD COMPANY** from all claims or liabilities whatever.

The **PANAMA RAIL ROAD COMPANY** will not be responsible for loss or damage to goods from fire in cars, in warehouse or on wharf.

And it is further stipulated and agreed, that Vessels are warranted seaworthy only so far as due care in the appointment or selection of Agents, Superintendents, Pilots, Masters, Officers, Engineers and Crew can secure it; and the Companies mentioned in this Bill of Lading will not be liable for loss, detention or damages arising directly or indirectly from latent defects in boilers, machinery, or any part of the Vessel, provided all reasonable measures have been taken to secure efficiency.

And it is further stipulated, that in all cases of loss of such goods and merchandise, the amount of claim and damage shall be restricted to the cash value of such goods or merchandise, at the port of shipment, at the time of shipment; and that all claims for partial loss or damage shall be ascertained and adjusted upon the same basis of value.

Not accountable for detention at ports of transhipment.

In case of the **blockade or interdict** of the port of delivery, or if, without such **blockade or interdict,** the entering of the port should be considered by the Master unsafe by reason of **disease, war or disturbances,** he is to have the option of landing the goods at any other port which he may consider safe, at shipper's expense and risk, and in such case the receipt of the Custom House or other port authorities to be accepted by the owners or consignees as a legal and thorough cancelling of this Bill of Lading. All quarantined expense incurred upon the goods, *of whatsoever nature and kind, to be paid by shippers or consignees of the goods.*

In all cases the ship's responsibility is to cease when goods have left the ship's deck.

Shippers of the goods named in this Bill of Lading must comply with all Consular Regulations for Manifests, Invoices, Certificates, etc.; and any fine imposed by Authorities at port of Destination, or damage resulting from the failure in this respect, or for Errors or Omissions therein, shall be *at risk and expense of the consignees of Goods,* and shall be paid by them.

The said Goods or Merchandise are shipped and received upon the conditions of the stipulations and provisions hereinbefore expressed, the *undersigned undertaking in behalf of the said parties, severally, and to the extent only, of the liabilities hereinstated to be assumed by* each of them respectively.

**In Witness Whereof,** the **Agent** of said **Steamer** hath signed Five Bills of Lading, all of this tenor and date, one whereof being accomplished, the others are to stand void.

Dated at New York, *this* Fifth *day of* May 1902

Accepted,

........ Shippers. G. J. Fauld

For PANAMA RAIL ROAD COMPANY,
PACIFIC STEAM NAVIGATION COMPANY,
or SOUTH AMERICAN STEAMSHIP COMPANY.

change," drawn by Burnham, Williams & Co., of Philadelphia, on the Peruvian Corporation, Ltd. The Baldwin Locomotive Works had sold a consignment of machinery to the Peruvian Corporation. At the time the goods were shipped, invoices were taken to the office of the Panama Railroad Co., and bills of

*A documented bill.*

CERTIFICATE OF INSURANCE.

The condition of Payment under this Certificate is that all claims shall be reported to Mr. ALAN H. BRODRICK, the Subscribers Agent at Liverpool (8-10 Liverpool & London Chambers), as soon as the goods are landed, or the loss known, to be adjusted according to usages of British Lloyds and the special conditions of the contract of insurance.

$1380—

No. B 16218

16218

AT UNITED STATES "LLOYDS,"

A. FOSTER HIGGINS, HERBERT ATKINSON, DOUGLAS F. COX } ATTORNEYS, { under the firm name of HIGGINS & COX

New York. May 6th 1902

We hereby Certify, 6th day

May 2 55268 made for

Johnson & Higgins

Thirteen hundred and eighty Dollars

on Machinery

S.S. Orizaba

S.S. Orizaba & con — New York via Panama —

Mollendo, Peru. Burnham Williams & Co

DUPLICATE

ORIGINAL and DUPLICATE issued one of which being accomplished the other to stand void.

Countersigned by Johnson & Higgins

Higgins & Cox

Attorneys for Subscribers at United States "Lloyds."

PREMIUM AND LOSS PAYABLE IN GOLD.

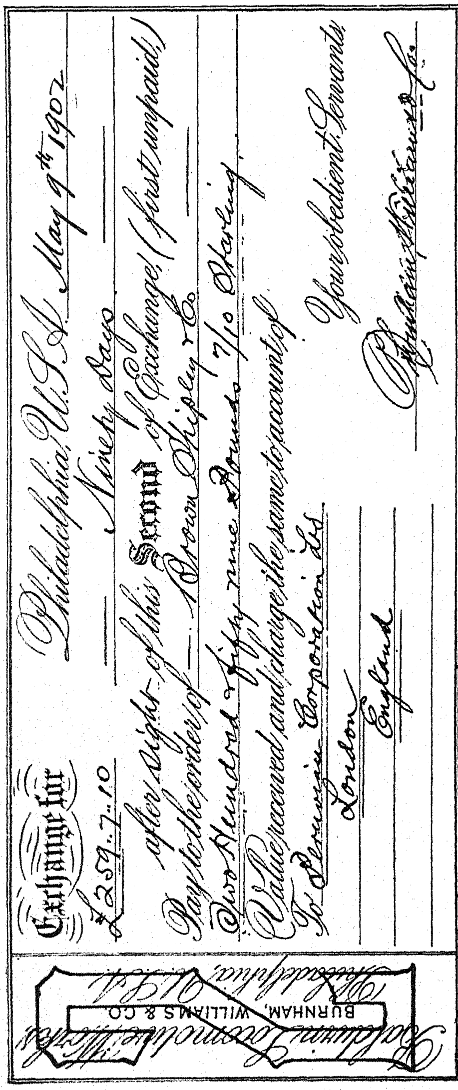
Payable on presentation of Certificate of Average ... ALAN H. BRODRICK ... the Counting House of either of the following:

Messrs. J. S. MORGAN & CO., London.
" MORGAN, HARJES & CO., Paris.
" GEBRUDER SCHICKLER, Berlin.
" H. ALBERT DeBARY & CO., Antwerp.
" A. C. FRASER & CO., Rotterdam.

Exchange fixed by agreement at {
Four and ... Dollars ($4.86) American Gold ... £ Sterling.
Five Francs six and one-quarter Centimes (F5.06¼) to the Dollar.
Ninety-eight cents per Four Reich-Mark.
Forty-two cents (42c.) to the Florin.

The Revenue Laws of Great Britain require that this Certificate must be stamped within Ten Days after receipt in the United Kingdom, otherwise loss cannot be collected there. Such stamps to be at expense of assured.

lading were taken out by Burnham, Williams & Co. in favor of themselves—i. e., they shipped the consignment by the steamer Orizaba to their own order, and had five copies of the bill of lading made out. At the same time duplicate ninety-day drafts were drawn, and an insurance policy was purchased from Lloyds to protect the property against loss. These—the invoices, the bills of lading, the insurance policy, and the two drafts—were taken to Brown Brothers & Co. for discount. Satisfactory arrangements having been made for the sale of the bills, Burnham, Williams & Co. indorsed and assigned them all over to


Exchange for £259.7.10 Philadelphia, U.S.A. May 9th 1902

Ninety Days after sight of this Second of Exchange (first unpaid)

Pay to the order of Brown Shipley & Co

Two Hundred & fifty nine Pounds 7/10 Sterling

Value received and charge the same to account of

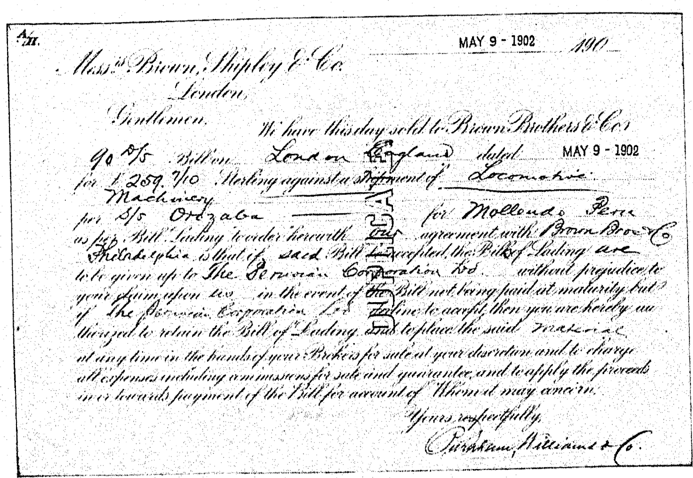
To Peruvian Corporation Ltd London England

Your obedient Servants

Burnham, Williams & Co.

BURNHAM, WILLIAMS & CO. Baldwin Locomotive Works Philadelphia, U.S.A.

Brown Brothers & Co.; that is, they executed a contract or bill of sale to Brown Brothers & Co., with instructions "that if the said bill be accepted, the bills of lading are to be given up to the Peruvian Corporation, Ltd., without prejudice," but "if the Peruvian Corporation, Ltd., declines to accept," then Brown Brothers & Co. were authorized to retain the


A/II. MAY 9 - 1902 190

Mess.rs Brown, Shipley & Co.
London,

Gentlemen. We have this day sold to Brown Brothers & Co.
90 D/S Bill on London England dated MAY 9 - 1902
for £259. 7/10 Sterling against a shipment of Locomotive
Machinery
per S/S Orizaba for Mollendo Peru
as per Bill Lading to order herewith our agreement with Brown Bros & Co
Philadelphia is that if said Bill be accepted, the Bills of Lading are
to be given up to The Peruvian Corporation Ltd without prejudice to
your claim upon us in the event of the Bill not being paid at maturity, but
if The Peruvian Corporation Ltd decline to accept, then you are hereby authorized to retain the Bill of Lading and to place the said material
at any time in the hands of your Brokers for sale at your discretion and to charge
all expenses including commissions for sale and guarantee, and to apply the proceeds
in or towards payment of the Bill for account of whom it may concern.

Yours respectfully,
Burnham, Williams & Co.

DUPLICATE

bill of lading and to place the said material at any time in the hands of their brokers for sale at their discretion, and to charge all expenses, including commissions for sale and guaranty, and to apply the proceeds on or toward payment of the draft for account of whom it may concern. In negotiating a documented bill, it is necessary that all copies of drafts and documents be turned over to the party buying it, otherwise a stranger having duplicates might forestall the owner and defraud the parties in interest. It is to be noted that the collateral here given was in the nature of security for "acceptance," only. After acceptance, the only contracts remaining were the credit contract, or promise to pay on the part of the Peruvian Corporation, Ltd., and the personal security of Burnham, Williams & Co. and

their indorsers for payment of the credit contract ninety days after acceptance.

The indorsements and other collateral contracts of security attached to drafts make these instruments of high commercial value. In the negotiating of foreign bills, such precautions are taken that one house doing several millions of this kind of business per annum has the phenomenal record of having lost only $600 during forty years of dealing. By sale of his draft on New York, the St. Louis merchant is enabled to obtain funds with which to pay for grain sold. On receipt of the grain by the New York merchant, he may at once trans-ship it to a Liverpool customer, and on his bills of lading draw for the amount. By sale of this he obtains funds with which to meet the St. Louis draft. The Liverpool merchant meets the draft on him by drawing on a Belfast brewer, who settles the draft on him by a bill on a New York importer of Irish stout. These international drafts or bills are settled by setting one off against another. Americans having accounts to meet in London, buy drafts against England, and Englishmen having American accounts to meet will buy drafts against New York. These secured bills, in their capacity as instruments for the collection of funds due "on account," come to serve in the capacity of funds for the payment of other accounts and avoid the necessity of shipping money from place to place in payment of credit obligations.

*Secured drafts used as funds.*

Drafts which are not paid at the time for which acceptance is made, or which are not accepted, may be protested. In fact, this is the usual custom when instructions are not given to the contrary. The protest of a bill puts on its face notice of its dishonor, and thereafter it ceases to serve as funds. No one will receive it in payment. It will be returned to the party drawing it, and he will be required to make good the amount, and pay all costs and expenses. When the drawer does not

*Non-payment and protest.*

wish to incur the expense of protest, he will have printed or attached to the end of the draft a detachable slip with the words, "*No protest. Tear this off before presenting.*" This is in the nature of private advice to one presenting. Except as between the most reputable houses, such drafts are not taken as readily in exchange for the reason that the very instruction itself may cast suspicion on the value of the paper.

## CHAPTER VIII

### FUNDS OBTAINED BY SALES OF LONG-TIME PAPER

THE credit instruments thus far described are those commonly used as a means of obtaining funds for current use—i. e., for commercial transactions; they are generally referred to as short-time or commercial paper. When funds are desired for more permanent use quite a different arrangement must be made. Instead of the credit being due on demand, or in thirty, sixty, or ninety days, it is made payable in five, ten, twenty, or perhaps fifty years. This precludes the use of accounts; it makes necessary a definite or formal, written contract—one which will place the terms and amount promised beyond all question. In form, all the instruments used for long-time credit transactions are in the nature of promissory notes. The credit contract itself does not differ from the commercial note except as to time of maturity; the essential difference between long-time and short-time paper is found in the contract of security given. One can make a conservative business judgment of the value of a promise to deliver money thirty or sixty days hence; in this the personal ability of the one offering his credit for sale to obtain funds with which to redeem it, and questions of integrity, can be determined with practical certainty. The incidents and accidents of life, and the shifting fortunes of business, however, make uncertain all judgments of personal condition to deliver funds twenty years hence; judgment as to the value of a contract for the delivery of

*Form of long-time credit.*

money twenty years hence, one which rests on personal ability and integrity alone, must be unfavorable. The credit contract in itself would be little valued; the one to whom it was offered in exchange for funds would refuse to buy it. A contract of security is added. Uncertainty being thus obviated, the long-time credit may be sold.

*Illustrations of difference in forms and uses of long- and short-time paper.*

To illustrate the different characters and uses of long- and short-time credit: Edward Strong and Leonard Williams decide to engage as partners in a general grocery business at West Point, on the Hudson. Each has $1,000 to put into the enterprise. This will give the firm $2,000 as cash capital. But they have no stock; they have no store building, no office fixtures, no counters or shelves, and no provision made for service. Besides, they estimate, a stock worth $2,000 would be too small a one to give profitable employment to themselves or to their capital. They need a stock of goods that will cost from $3,000 to $5,000, a building, and other business equipment. How shall they obtain the funds? By consultation with the West Point National Bank they find that funds may be obtained there to finance their stock purchases; an arrangement is made through the president and cashier of the bank whereby the grocers are to keep their account with them, and, on bills being presented for stock purchases, Strong & Williams will execute their promissory notes, the bank to give the firm a credit on its books in exchange for stock notes to an amount not to exceed $5,000, as occasion may require. As a part of the agreement, the grocery company is to "deposit" all cash received from customers—all money and checks received from sales as fast as they are made. This arrangement will enable Strong & Williams to buy for cash, and to take advantage of the trade discounts offered by the wholesale house. The notes are to be made payable on or before ninety days, for the reason that it is estimated that the stock will be turned over, or sold,

once every three months. In such a transaction the bank requires no *security*; it is willing to rely on the integrity of the partners and their ability to make payments out of sales—in other words, it is willing to rely on their unsecured credit. Strong & Williams now have established a line of credit good for $5,000 for stock purchases, and, besides, they have their original $2,000 for working capital. But how about a building and other equipment? A well-located store-room is found which they may rent at $50 per month—$600 per year. Just across the street is a vacant lot, however, which may be purchased for $1,000. If they buy this vacant lot instead of renting the store-room, they can put up a suitable one-story building for $1,000 more. The whole property will cost only $2,000; the interest on this will be $100 per annum. By such an arrangement there will be a clear gain of $500 per year. They decide to buy the lot for $1,000, and to spend the other $1,000 of the original capital for a building. But having done this they have no funds left. To complete their equipment, some provision must be made for current funds. Current expenses must be paid; the partners themselves must live; they must pay clerks, delivery, obtain supplies of fuel, meet incidental expenses, etc. At least $1,000 more of permanent capital is required before they are ready to begin business. The West Point National Bank is willing to take their short-time notes for funds with which to make stock purchases, but it is not willing to contribute permanent capital—its own business is so organized that it must be able to collect funds whenever demands are made by depositors. The problem of getting more permanent funds is solved by arrangement with the Dime Savings-Bank. This institution is willing to give Strong & Williams $1,000 for their note, due five years hence, bearing interest at the rate of $4\frac{1}{2}$ per cent and secured by a mortgage on the building and lot. Current funds being provided for in this manner, they take the $1,000 received from the sale of the mortgage note, de-

posit it in the West Point National Bank, order a $3,000 stock of groceries in New York, execute ninety-day notes for this amount, and pay for the goods by check on their account at the bank; they begin business, make payments to the bank from sales, and execute new notes for adding to and enlarging their stock as trade and sales may require.

If we look at the balance-sheet of the Strong-Williams Company on the day that they first received their $3,000 stock and paid for it, the following financial summary would appear:

BALANCE SHEET, July 1, 1897.

| | | | |
|---|---|---|---|
| ASSETS (or business equipment procured by expenditure of the funds contributed). | | LIABILITIES (for funds contributed). | |
| | | *By Proprietors:* | |
| | | Edward Strong... | $1,000 |
| Store building and lot .............. | $2,000 | Leonard Williams. | 1,000 |
| Stock.............. | 3,000 | *By Creditors:* | |
| Cash (West Point National Bank)...... | 1,000 | The Dime Savings-Bank, Mortgage Loan .......... | 1,000 |
| Total value of assets. | $6,000 | Loans, West Point National Bank.. | 3,000 |
| | | Total liabilities.. | $6,000 |

This gives a picture of the financial arrangement, the sources from which $6,000 of funds were procured for the enterprise, and the equipment procured by the use of these funds. From this, it appears that $2,000 were contributed by the proprietors themselves, while $4,000 came from the creditors of the concern. Of the credit sold (as a means of obtaining these $4,000) that for $3,000 was in the form of short-time (commercial) credits, and that for $1,000 was a long-time credit contract secured by mortgage.

There are two classes of long-time credits, viz., "*mortgages*" and "*bonds*." Each class may have the same kind of security, but the first takes its name from the contract of security, the second from the character of the note or credit contract given. It is stated that each may have the same kind of security. This follows as a necessity from the length of time agreed upon for payment. Each requires that the ultimate performance of the credit contract be assured, and any security which would be sufficient to assure the payment of one form of long-time credit obligation would be sufficient for the other. The difference in the two classes of instruments arises from the advantages of sale of the credit contracts secured, and from the form which the credit "issue" takes. When it is desired to have the secured obligation for future delivery of money divided into a large number of small credit contracts, and sold separately, a bond issue will be resorted to; if one party is found who is willing to purchase the whole amount secured and hold it in lump sum, or in the form of a few large credit contracts, the "mortgage" will be offered.

*Classes of long-time credits.*

### Mortgages

That which commonly goes in the security market as a "mortgage" is a misnomer; it is in reality a credit obligation secured by a mortgage. The mortgage is only a part of the thing bought and sold; in fact, if one held only the "mortgage" or security contract it would be of little value. The promise for the delivery of money is found in a "promissory note" or other evidence of debt. The mortgage is only a collateral contract which gives to the creditor a contract of lien on the property named as security for the payment of the contract of credit. If there are several credit contracts secured by the same mortgage, these may be sold to different persons, and the one who holds the mortgage will be held to be the trustee for them all. When the credit

*What is a "mortgage"?*

contracts are paid the mortgage has no further validity, and may be declared void if action is brought to clear the title to the property against which it is given. There is no more reason for the secured debt of one individual (or of a partnership,) being called a "mortgage security" than there is for the debt of a corporation issuing bonds, except that usually the mortgages and credit contracts are kept together. The term "mortgage," however, is sanctioned by commercial usage, instead of the descriptive phrase, "a credit contract

$1,000.$^{\underline{00}}$ WEST POINT, NEW YORK, June 1, 1897.

Five years after date we and each of us promise to pay to the Dime Savings-Bank of West Point, or order, for value received, One Thousand Dollars, with interest payable annually, on June 1 of each year, at the rate of $4\frac{1}{2}\%$ per annum.

This note is secured by mortgage, of even date herewith.

EDWARD STRONG.
LEONARD WILLIAMS.

secured by a mortgage." A mortgage is a contract which gives to the one in whose favor it is made the exclusive right, on default, to sell the property named in it, as a means of procuring funds with which to pay the credit contract thus secured. In form, the mortgage is a conveyance of property, with the condition that if the debt is paid the conveyance is to become void. When stripped of its legal phrases it is, in substance, as shown on page 155.

It will be noted that the contract is one of sale. It is, in fact, a deed to the property, and if a regular deed is drawn to which the condition of security for payment is added, the mortgage will be complete. By making the mortgage a conditional sale, and making the sale a matter of public record, so that the public may have notice of the transaction, Strong & Williams can not sell the property to any one else and pass a good title. This guarantees to

This contract witnesseth: That

WHEREAS, Edward Strong and Leonard Williams have this day executed their promissory note to the Dime Savings-Bank of West Point, or order, for the sum of One Thousand Dollars, due five years from date, with interest at the rate of $4\frac{1}{2}\%$;

NOW, THEREFORE, the said Edward Strong and Leonard Williams, in consideration of the aforesaid One Thousand Dollars to them in hand paid, as evidenced by said promissory note, and for the securing of the payment of the same unto the said Dime Savings-Bank, or its assigns, have sold and conveyed to the said Dime-Savings Bank of West Point the following described property, to wit: Lot numbered 246, in Block numbered 36, on Laurel Street, in the Town of West Point, in the State of New York, according to official plate thereof, filed for record in the office of the Auditor of the County of Kings, in the State of New York.

The condition of this contract is, that if the said Edward Strong and Leonard Williams shall pay to the said Dime Savings-Bank, or its assigns, the sum or sums promised in said note according to the tenor thereof, then this contract shall be null and void, otherwise to remain in full force and effect.

IN WITNESS WHEREOF we have hereunto set our hands and seals this 1st day of July, 1897.

EDWARD STRONG. [Seal]
LEONARD WILLIAMS. [Seal]

Witnesses: { LINCOLN STETSON.
JOHN M. BROMLEY.

the Dime Savings-Bank the sole power to sell the property of Strong & Williams; it also reserves the property to them as a means of obtaining funds with which to meet their note when due five years hence. The result is that the Dime Savings-Bank has confidence that their long-time note will be paid. They can pass a conservative judgment as to its value, and having the payments of principal and interest secured, the bank offers to Strong & Williams $1,000 for their contracts, to deliver $1,000 five years hence, together with current interest payments of $45 annually.

*Mortgage contracts one of sale.*

Sometimes a memorandum of credit is included in the mortgage itself instead of being in a separate instrument, in which case the two obligations may not be separated. The laws of some States make a difference in the content of such agreements. The laws of the State of Washington, for example, provide that when the credit contract is not widened by a separate instrument, the creditor may not collect any deficiency remaining after the sale of the property mortgaged. Generally speaking, however, the funds derived from a sale of the mortgaged premises are to be applied to the payment of the "note"; any amount that remains unpaid is still a charge against the maker of the note.

*Mortgage without separate note.*

When one wishing to sell his note has no property of his own, he may get a friend to give a mortgage on his property as security. In this case, one person will execute the note and receive the benefit of the funds, while another will execute the mortgage contract of security. This is the same kind of accommodation as the indorsement of another man's note, except that it gives to the creditor a lien security instead of a personal one.

*Accommodation mortgage.*

In Pennsylvania, Delaware, and several of the States that still follow old English practice, a promissory note is seldom used as evidence of the credit contract to which a mortgage on real estate is given for security. To illustrate:

**Know all Men by these Presents** That *I, J. William White, of the City of Philadelphia, Contractor* (hereinafter called the Obligor), *am* held and firmly bound unto *John Doe of the same City, Merchant*

(hereinafter called the Obligee), in the sum of *Five Thousand Dollars* lawful money of the United States of America, to be paid to the said Obligee, *his* certain Attorney, Executors, Administrators or Assigns: to which payment well and truly to be made, *I* do bind and oblige *myself, my* Heirs, Executors and Administrators, *all and singular* firmly by these Presents. Sealed with *my* Seal, dated the *First* day of *April* in the year of our Lord one thousand nine hundred *and three.* **The Condition of this Obligation is such,** That if the above-bounden Obligor, *his* Heirs, Executors or Administrators, or any of them, shall and do well and truly pay, or cause to be paid unto the above-named Obligee, *his* certain Attorney, Executors, Administrators or Assigns, the just sum of *Two Thousand Five Hundred Dollars* lawful money as aforesaid, *within three years from this date,*

together with interest
payable *half yearly* at the rate of *six* per cent per annum,
without any fraud or further delay; and shall produce to the said Obligee, or *his* Executors, Administrators or Assigns, on or before the *first* day of *September* of each and every year, receipts for all taxes of the current year assessed upon the mortgaged premises ; then the above Obligation to be void, or else to be and remain in full force and virtue: **Provided,** however, and it is hereby expressly agreed, that if at any time default shall be made in payment of interest as aforesaid,
for the space of *thirty* days after any *half-yearly* payment thereof shall fall due,
or in such production to the Obligee or *his* Executors, Administrators or Assigns, on or before the *first* day of *September* of each and every year, of such receipts for such taxes of the current year upon the premises mortgaged, then and in such case the whole principal debt aforesaid, shall, at the option of the said Obligee, *his* Executors, Administrators or Assigns, become due and payable immediately, and payment of said principal debt,
and all interest thereon, may be enforced and recovered at once, any thing herein contained to the contrary notwithstanding. **And Provided further,** however, and it is hereby expressly agreed, that if at any time hereafter, by reason of any default in payment, either of said principal sum at maturity, or of said interest, or in production of said receipts for taxes, within the time specified, a writ of Fieri Facias is properly issued upon the Judgment obtained upon this Obligation, or by virtue of the warrant of attorney hereto attached, or a writ of Scire Facias is properly issued upon the accompanying Indenture of Mortgage, an attorney's commission for collection, viz., *five* per cent, shall be payable, and shall be recovered in addition to all principal and interest then due, besides costs of suit.

Sealed and Delivered in the presence of us: D. S. Lindsay. Jon Edwards. J. William White. Seal

Mr. J. William White desires to obtain $2,500, and, as security, offers a mortgage on real estate estimated to be worth $5,000. Instead of executing a promissory note—an unconditional contract for the future delivery of $2,500, with interest, etc.—he executes an "indemnity bond," i. e., a conditional contract for the payment of $5,000, the condition of which as stated "is such that if the above bounden obligor, J. William White, his heirs, executors, administrators, or any of them shall, and do, well and truly pay or cause to be paid . . . the sum of twenty-five hundred dollars," etc. This personal contract of guaranty, together with a mortgage on the real estate mentioned, will be exchanged for the $2,500. In such a transaction there is no writing which sets out the contract of credit in detail. Evidence as to the credit contract is left to the memorandum contained in the indemnity bond and in the mortgage. There are, however, two contracts of security for the payment of the credit contract—(1) a personal contract of security in the form of an indemnity bond and (2) a contract of lien security in the form of a mortgage. Under such a practice in Pennsylvania, a creditor may file the indemnity bond with a prothonotary and obtain a judgment entry before default on the credit obligation, and thus establish a lien on all other real property owned by the maker. As a result a "straw bond" is usually executed in real-estate mortgage transactions—that is, one who knows the law will usually get some one to make the bond who has no property; he will also pass a deed to this "straw man," and then he will execute the mortgage. The evils of the law may thus be avoided by the more intelligent; it operates as a trap, however, to catch the unwary. There is only one explanation for such a lumbering, indirect, and unjust system of credit—viz., a slavish following of inherited forms of law and business practice.

*The indemnity bond and mortgage.*

The chattel mortgage pertains to business and properties where the chief assets are *personalty*. A manufacturer

rents his building, mechanical equipment, and power; he procures another part of his equipment by means of capital funds, obtained on credit, and gives his promissory note for the amount. To secure the funds needed he gives a mortgage on his products. These products are so shifting in nature and unstable in value that they are not usually found in the general security market. They are more usually given to banks or local investors or to supply houses. They belong to the short-time or commercial-paper class rather than to long-time credit transactions.

*Chattel mortgages.*

A farmer owns a piece of unimproved land. He can make it productive only by building fences, houses, and drains, and by procuring machinery and horses with which to till the soil. He goes to a loan company for the needed funds, offering a mortgage on the land as security. Mortgages upon improved farm property, if properly graduated in amount, are safe and profitable investments. The buyer, however, must exercise care and judgment. Unimproved land is not the best character of security even though the funds are used to improve it. The margin of value is usually a small one between actual cost of improvement and the selling price after the improvement has been made. Should there be collusion between the loaning agent and the landowner, the money advanced may be largely in excess of the actual property value. One of the devices of these enterprising companies is to offer their own guarantees as to both principal and interest of all mortgages negotiated by them. The investor should be sure of two things: (1) the safety of the principal; (2) regularity in the payment of the interest. In some portions of the United States there is great danger of default from causes such as drought, floods, hail, and violent winds—causes that may not be anticipated by the farmer and over which he has no control. This makes the income of the farmer uncertain, and often causes

*Farm mortgages.*

# PARTI-MORTGAGE RECEIPT

NUMBER

DOLLARS 5000.

This Certifies that the **Conveyancers Title Insurance Company,** (hereinafter called "the Company") has received from the Bearer Five Thousand Dollars in purchase of a parti-interest to that amount in a certain Note secured by Mortgage (hereinafter called "the Note") for ____________ Dollars given by ____________ to it due ____________ and recorded with ____________ Deeds, Book ______ Page ______ it being hereby agreed that the Bearer shall receive no assignment of the Mortgage other than this Receipt, that said Note shall remain in the care, custody and name of the Company which alone shall have as full and complete powers in reference thereto as if it was the absolute owner thereof, including that of collecting and receiving payment and of making a valid and binding Discharge thereof, of exercising in its discretion the power of sale, and in general of doing any and every thing customary and proper for a mortgagee to do, the net proceeds, after deducting all reasonable and proper charges to be held for and distributed by the Company pro rata among the part owners of the Note, the Bearer being one such, but nobody claiming under the Mortgagor shall in any event be bound to see to the application of the money. The Company, as of its current Mortgage Form hereby insures against all encumbrances of record except as set forth or referred to in the said Mortgage, certifies that at the time of record thereof it was a first lien on the mortgaged property, and agrees to attend to the fire insurance in the usual way and use its best endeavors to promptly collect and distribute the interest and principal of the Note. If the Company, in its discretion, extends the time of payment of the Note it shall redeem this Receipt in cash. The Bearer, for return of his money, relies entirely on his proportionate share of the Note or its proceeds, and also agrees that ownership herein shall pass by delivery until this receipt is registered, when it shall be transferable only on the books of the Company.

**In Witness Whereof** the Company has caused these Presents to be signed by two of its Officers on this ______ day of ____________

____________ President.

____________ Treasurer.

him to default in his payments. It is a judicious exercise of investment judgment not to contribute large capital to such an enterprise on credit; it encourages the farmer to become encumbered in obligations which he can not meet, and involves the investor in trouble, loss of time, and loss of capital.

*Mortgages on "business property."*

Among the best kinds of mortgage securities are those held against improved city real estate, but of this class well-located "business property" is usually preferable to residence property. The reason for that is that business property is a regular and necessary part of business equipment, and credit promises secured by liens on such property become a first claim against "net income" of business; residence property, on the other hand, is not used for the purpose of income; the rents which support such investments must come from the "net profits" of other business after the expenses, interest, taxes, etc., have been paid. Fluctuations in values of residence properties are usually greater than those of well-located business properties, and they are not as good security on this account. The exercise of proper judgment and a sufficient margin of safety may make either class of securities equally good; failure to exercise such judgment may make either equally bad.

*Mortgages on mines and timber lands.*

Mortgages on mines are peculiar. By utilizing the resource against which the mortgage lien is given, and on which the industrial manager must rely for his income—in fact, by pursuing the very object for which the capital contribution is obtained—the mine becomes exhausted and the security depreciated. This must be taken into account in estimating the value of the security. Generally speaking, provision should be made for a sinking fund—i. e., for annual reduction of the principal loan. Another method of protecting the mortgagee's interest is to make the whole principal due within such a time as to prevent exhaustion of the property. It is never

No.

GOLD

# Collateral 5 PER CENT Certificate

FOR VALUE RECEIVED

Rufus Coffin & Co. promise to pay to the order of the sum of dollars on or before ten years from the date hereof with interest thereon at the rate of five per cent. per annum payable semi annually both principal and interest being payable at the office of said Coffin & Co. in Boston in gold coin of the United States of the present standard of weight and fineness upon presentation of this obligation at said office. To secure the payment of this obligation said Coffin & Co. covenant and agree with the holder hereof to hold the property mortgages mortgage notes bonds or other securities described in the schedule on the back hereof to sell or otherwise dispose of the same or convert them into money and to hold and apply the same or the proceeds thereof to the payment of this obligation, and upon default in payment of any instalment of the interest hereon, such default continuing for thirty days after demand therefor, the holder hereof shall have the right to demand from said Coffin & Co. and said Coffin & Co. agree to transfer and deliver to the holder hereof the property or securities mentioned in said schedule or the proceeds thereof then in their hands or under their control, and thereafter said Coffin & Co. shall have no claim upon or interest in the same or any of the same. Said Coffin & Co. may from time to time make partial payments on account of the principal sum of this obligation. The holder of this obligation on requesting the same in writing shall be entitled to have on the first day of January in each year until this obligation is paid a statement of account made up by said Coffin & Co. reciting the securities held by them as collateral to this obligation and the proceeds of such as shall have been sold or otherwise disposed of.

Dated at Boston, Massachusetts this day of 189

safe to allow loans of this kind to run twenty or fifty years, as is common in some classes of mortgages.

*Parti-mortgage receipt.*

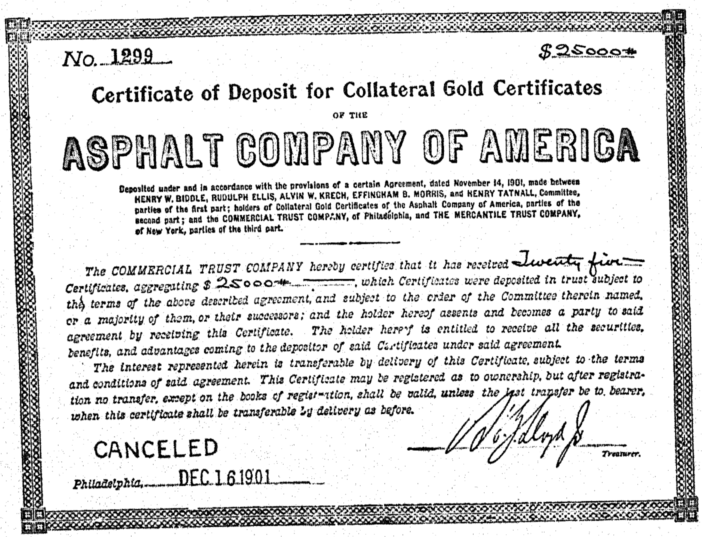
Mortgage-notes are usually in large amounts—they commonly cover the whole sum borrowed, unless there is some advantage in having the principal sum paid at different dates. This may make them difficult of transfer, for the reason that the investor may not have the amount of the note available; if available, then he may not wish all of his available funds in one property or credit instrument. As a means of finding a more ready market for mortgages, financial houses have devised what is known as a "parti-mortgage receipt." This is a certificate of the company holding the mortgage that the holder has purchased a *pro-rata* interest in the mortgage. Let us suppose that a note is given for $100,000, due in ten years, secured by mortgage. For convenience of sale, 20 certificates of $5,000 each will be issued and sold by the company taking or holding the original security. These certificates of interest in the original mortgage-note are sold, and thereafter the company holding the mortgage becomes trustee for the holders of certificates (see page 158).

*The collateral certificate.*

In further application of this principle the collateral certificate has come into use. This is a certificate of interest in a number of securities held in trust. A collateral trust is formed—i. e., certain collateral securities are placed in the hands of a trustee. Against this, collateral certificates are issued and sold in denominations to suit the demands of the market. Both of the above forms of financial instrument bear a close resemblance to bonds; in fact, they may be said to be a "cross" between a bond and a mortgage security. The form used by Rufus Coffin & Co. is exhibited on the opposite page. A copy of a $25,000 collateral trust certificate issued by the trustees of the American Asphalt Company (see page 162) is of special interest in this relation, on account of the recent failure of that company.

## Bonds

Bonds, as credit contracts, are not to be confused in thought with bonds as contracts of indemnity. Bonds, as instruments of credit, where negotiable, may differ from promissory notes only in this, that they are issued in series. For example: Mr. Russell Sage may wish to build a large office building in New York. Let us say that he owns a lot at the corner of Broadway and Fourth Street, which is valued at $500,000. The office building that he has planned for



No. 1299 $25000

**Certificate of Deposit for Collateral Gold Certificates**

OF THE

**ASPHALT COMPANY OF AMERICA**

Deposited under and in accordance with the provisions of a certain Agreement, dated November 14, 1901, made between HENRY W. BIDDLE, RUDULPH ELLIS, ALVIN W. KRECH, EFFINGHAM B. MORRIS, and HENRY TATNALL, Committee, parties of the first part; holders of Collateral Gold Certificates of the Asphalt Company of America, parties of the second part; and the COMMERCIAL TRUST COMPANY, of Philadelphia, and THE MERCANTILE TRUST COMPANY, of New York, parties of the third part.

*The COMMERCIAL TRUST COMPANY hereby certifies that it has received* Twenty five *Certificates, aggregating $* 25000 *, which Certificates were deposited in trust subject to the terms of the above described agreement, and subject to the order of the Committee therein named, or a majority of them, or their successors; and the holder hereof assents and becomes a party to said agreement by receiving this Certificate. The holder hereof is entitled to receive all the securities, benefits, and advantages coming to the depositor of said Certificates under said agreement.*

*The interest represented herein is transferable by delivery of this Certificate, subject to the terms and conditions of said agreement. This Certificate may be registered as to ownership, but after registration no transfer, except on the books of registration, shall be valid, unless the last transfer be to bearer, when this certificate shall be transferable by delivery as before.*

CANCELED

*Philadelphia,* DEC 16 1901

*Treasurer.*

erection on this site is estimated to cost $1,000,000. He has $250,000 in cash, which is available for the purpose. How will the remaining $750,000 be obtained? Mr. Sage calculates that by borrowing $750,000, at 4 per cent, the income from the rents will be sufficient to pay interest, meet all expenses for repairs, depreciation, taxes, etc., give to himself a dividend of 5 per cent on the value of the lot and $250,000 invested by himself, and leave a surplus suf-

ficient to pay off the $750,000 loan in fifty years. On inquiry, however, he finds that he can not get $750,000 from any one person or investment company. No one wishes to risk so much on the security of a single property. The center of business may change; the properties adjoining

> $1,000. No. ......
>
> I, Russell Sage, an unmarried man of the City of New York, State of New York, for value received, promise to pay to the holder of this bond the principal sum of One Thousand Dollars, gold coin of the United States, of present weight and fineness, at the office of the Union Trust Company of New York, on the first day of January, 1948, with interest thereon at the rate of 4%.
>
> This bond is one of a series of first-mortgage bonds issued by the said Russell Sage amounting in all to the sum of Seven Hundred Fifty Thousand Dollars ($750,000), all of the same date, for the sum of One Thousand Dollars each, and each of which is numbered from one (1) to seven hundred fifty (750) inclusive, and all of which are secured without discrimination or preference by a first mortgage duly executed by said Russell Sage on the following property: Lots numbered forty (40) and forty-two (42) of Block numbered ninety-six (96), of the City of New York, together with the buildings and improvements erected thereon, or hereafter to be erected, the same being located on the northwest corner of Fourth Street and Broadway in the City of New York.
>
> RUSSELL SAGE.

may come to be used for manufacturing purposes; many changes are possible within fifty years which would cause his property to depreciate in value and impair the security of the loan. Those persons who make it a business to loan money on business property will not invest all their funds in one security; they prefer to invest in a variety of securi-

ties as a protection against loss. While they are not willing to take the whole amount, they would gladly invest in a portion of the amount if each part were equally well secured. In order to effect this, he decides to divide the loan into 750 parts of $1,000 each, and give to the Union Trust Company a mortgage on the property as security for payment of interest and principal. In other words, he decides to issue a series of seven hundred and fifty first-mortgage notes or bonds, in form the same as the bond or note shown on page 163, but numbered serially.

*The trust company as agents of sale and transfer.*

Having executed his bonds and mortgage, Mr. Sage places them, together with $250,000 in cash, in the hands of the Union Trust Company, under an agreement that they may dispose of the bonds to purchasers, and that when the entire issue has been disposed of (not until then) a contract will be made for the erection of the building, according to the plans and specifications previously adopted, the trust company to have the general supervision of the construction and of payments. The Mercantile Trust Company, as trustee of the Peter Cooper estate, has funds to be invested, and after examining the security for the payment of the bonds offered by Mr. Sage, it decides to take one of them at $1,000. The Mercantile Trust Company therefore makes a deposit with the Union Trust Company, for which the Union Trust Company gives its receipt in form similar to that shown on the opposite page.

Such a contract protects the purchaser against loss on account of failure to sell the entire issue, while the contract of trust which gives to the Union Trust Company the superintendence of the construction and the disbursement of funds, amply protects the bondholders' security. When the entire issue has been disposed of, the trust company will deliver the bonds to respective purchasers, and as a result of the bond sale will have $750,000. On page 166

is a copy of a receipt used in the bond sale of the Glen Echo Railroad Company.

$1,000. NEW YORK, November 17, 1897.

This is to certify that the Union Trust Company has received from the Mercantile Trust Company, trustee of the Peter Cooper estate, One Thousand Dollars on deposit for the purchase of one bond of an issue of Seven Hundred Fifty, each for the sum of One Thousand Dollars, executed by Russell Sage of New York, and secured by mortgage on Lots 40 and 42, Block 96, of the City of New York, together with the buildings to be erected thereon, to be known as the Sage Block, at the northwest corner of Fourth Street and Broadway, which said bonds and mortgage, together with a cash deposit of $250,000 made by Russell Sage, are held in trust by the Union Trust Company.

The condition of this deposit is, that if all of the said issue shall be sold at par on or before January 1, 1898, then the Union Trust Company will deliver to the above-named depositor the bond herein contracted for; but that in case the entire issue shall not be so sold, then the said deposit may be withdrawn, and in any case, without further authorization, it shall not be applied to the purchase herein described and set forth.

THE UNION TRUST COMPANY,
Jacob Fressenden, *President.*

*Unsecured bonds.*

The amount received from bond sales, added to the $250,000 cash deposit made by Mr. Sage, provides the $1,000,000 to be expended in the erection of the office building, on the disbursement of which the lot and structure will stand as security for the payment of the bonds. Herewith (page 167) is given a copy of bond issued by the Bank of the United States after

it was incorporated under the laws of the State of Pennsylvania. This was an unsecured bond. It had no mortgage or other collateral contract to vouchsafe its payment. The purchaser relied entirely on the credit of the bank. It stands on the same basis as an unsecured note, except that the issue was in even amounts of £1,000 each, and ran fourteen years instead of being made payable in sixty or ninety days.

INCORPORATED UNDER THE LAWS OF THE STATE OF MARYLAND

No. TOTAL AUTHORIZED ISSUE OF BONDS $ 200.000.

The Glen Echo Railroad Company

Received from Amount $

the sum of Dollars being the first instalment of Fifty per cent. upon subscription to of the first mortgage bonds of Dollars each of The Glen Echo Railroad Company, the balance of said subscription being payable in thirty days hereafter.

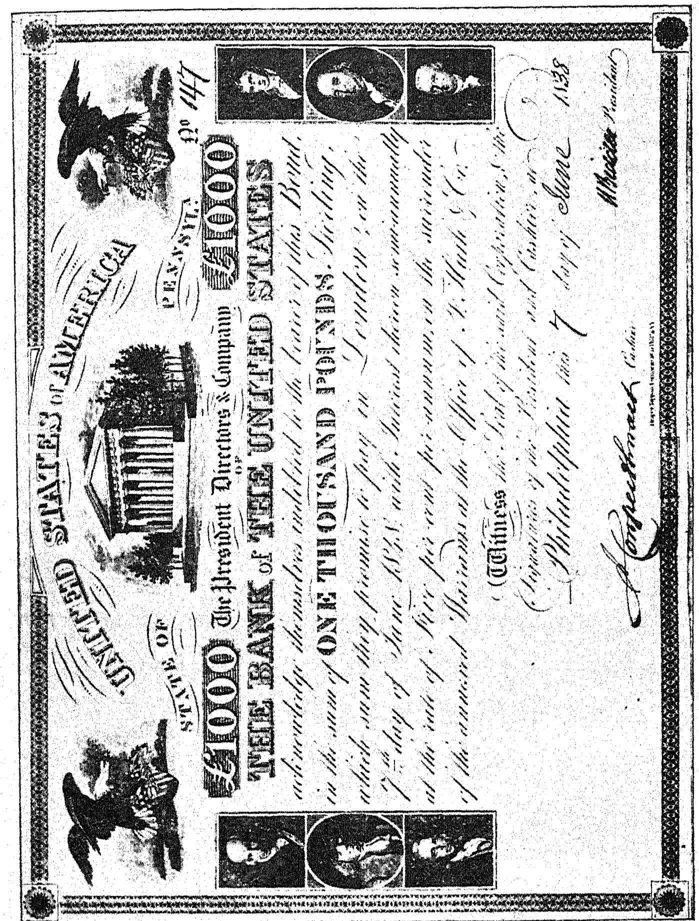
Said bonds are to bear interest at the rate of Six per cent per annum until their maturity June 1st 1916, when the principal sum thereof shall be payable in gold.

Actual delivery of said bonds with proper interest coupons attached, shall be made as soon as the same are engraved and ready to be issued to the above named subscriber or assigns, together with a bonus of $ of the full paid stock of said Company at par upon surrender of this receipt for cancellation with all instalments due thereon paid.

Dated at Philadelphia, Pa. this day of One thousand eight hundred and ninety six (1896).

The similarity in form of bonds to promissory notes, as well as the advantage of serial issue, is illustrated by the first mortgage real-estate bonds of the Philadelphia Mortgage and Trust Company (page 168). This company has loan offices in different parts of the country. The bond here shown is one provided for its Birmingham agent. One wishing to obtain $20,000 on improved real estate in Alabama, will issue 20 bonds or notes in series, each of which is a contract for the payment of $1,000. These will be secured by a mortgage executed to the Philadelphia Mortgage and Trust Company. The Philadelphia company will buy the entire issue. It will then hold the mortgage, or assign it in

trust to some trust company to be held as security for the payment of all, and sell the notes thus secured to customers in


UNITED STATES of AMERICA

STATE OF PENNSYLA No 147

£1000 The President Directors & Company OF THE BANK of THE UNITED STATES £1000

acknowledge themselves indebted to the bearer of this Bond in the sum of ONE THOUSAND POUNDS Sterling, which sum they promise to pay in London on the 7th day of June 1841 with interest thereon semiannually at the rate of five per cent per annum on the surrender of the annexed Warrants at the Office of [illegible]

Witness the Seal of the said Corporation & the Signatures of the President and Cashier at Philadelphia this 7 day of June 1838

[illegible] Cashier [illegible] President

such numbers or amounts as its customers may desire. This arrangement allows the notes to be placed on the market and disposed of to better advantage to all parties than if

UNITED STATES OF AMERICA.

NUMBER

DOLLARS

# FIRST MORTGAGE REAL ESTATE BOND

NEGOTIATED BY THE

# PHILADELPHIA MORTGAGE AND TRUST COMPANY.

INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF PENNSYLVANIA.

Birmingham, Alabama. A.D. 189

On the first day of ______ A.D. Eighteen hundred and ______ for Value received ______ promise to pay to the Philadelphia Mortgage and Trust Company or order at their Office in the City of Philadelphia, Pennsylvania, the principal sum of ______ Dollars in gold coin of the United States of America, of present standard of weight and fineness, with interest thereon at the rate of ______ per centum per annum from the date hereof until maturity, payable semi-annually according to the tenor of ______ coupons hereto attached at their Office in Philadelphia, Pennsylvania. Unpaid interest shall bear interest at the rate of Eight per cent per annum. On failure to pay interest within twenty days after it is due the holder may collect the principal and interest at once. The right of exemption as provided in the Constitution and Laws of Alabama or any other State in the United States, is hereby waived and it is further agreed, that the undersigned shall pay all costs for collecting the above sum with interest including reasonable Attorney's fees, on failure to pay at maturity.

In the presence of

the contract for payment were in one instrument. An exhibit is also shown on page 170 of a form of bond issued by Mr. William E. Bailey, of Seattle, Washington, as a means of obtaining a part of the funds necessary for the erection of an office building in that city known as the Bailey Building.

*Bonds distinguished from notes.*

The only way that a bond is distinguished from an ordinary promissory note is by the fact that it is issued as a part of a series of like tenor and amount, and, in most cases, under a common security. By rule of common law the bond is also more formal in its execution. The note is a simple promise (in any form, so long as a definite promise for the payment of money appears upon its face), signed by the party bound, without any formality as to witnesses or seal. The bond, on the other hand, in its old common-law form, required a seal, and had to be witnessed in the same manner as a deed or other formal conveyance of property, and though assignable was not negotiable. This is still the rule within many jurisdictions.

*Security for bonds.*

The contract of security for the payment of a bond issued may be one giving to the holders a lien on property, or it may be entirely personal. For example, one may wish to obtain $100,000. To this end one may offer for sale 1,000 bonds for the payment of $100 each. If the purchaser or purchasers are not content to rely on the unsecured promise of the maker, personal security may be added—they may be guaranteed, or, when negotiable, indorsed. The security for a bond issue, like that of a note, may be found written upon the face or back of the bond itself. On the margin of the certificate of indebtedness (or bond) of the Ocean View Cemetery Company will be found the written guarantee of the Metropolitan Land Company, as follows:

FOR VALUE RECEIVED THE METROPOLITAN LAND COMPANY HEREBY GUARANTEES THE PAYMENT OF BOTH PRINCIPAL AND INTEREST ON THIS CERTIFICATE WHEN DUE. NEW YORK, SEPTEMBER 10TH 1901

METROPOLITAN LAND COMPANY.

By ............................................ PRESIDENT.

United States of America. State of Washington.

Six per cent

$1000 First Mortgage Bond. No.

Issued by William E. Bailey

of Seattle, State of Washington.

Know all men by these Presents that I, William E. Bailey, an unmarried man of the City of Seattle, State of Washington,
for value received, am indebted to the holder of this bond in the principal sum of One Thousand Dollars, which sum I promise to pay in the Gold Coin of the
United States of America of the present standard of weight and fineness or its equivalent in United States currency, at the Office of the Philadelphia Mort-
gage and Trust Company, in the City of Philadelphia, State of Pennsylvania, on the first day of December A.D. 1895, with interest thereon at the rate of
Six per centum per annum, payable in like gold coin, according to the coupons hereto attached from the first day of December A.D. 1890 payable semi-annually
at the Office of the Philadelphia Mortgage and Trust Company in the City of Philadelphia, State of Pennsylvania, on the first days of June and December in
each year until said principal is fully paid, on delivery of proper coupons therefor, without deduction from either principal or interest for any tax or taxes,
which may be payable under any present or future laws of the United States of America, or the State of Washington for National, State or Municipal purposes,
I the said William E. Bailey hereby agree to pay any such tax or taxes which I may now or hereafter be required by any laws to retain therefrom.
It is also expressly agreed, that if default be made in the payment of any of said coupons and continues for thirty days after the same shall have become due, the
principal of this as well as of all the bonds of the issue of which this is one, may thereupon be declared due and collectible at the election of the mortgagee or the
legal holder hereof. Unpaid interest shall bear interest at the rate of twelve per centum per annum until paid.
This bond is one of a series of first mortgage bonds issued by the said William E. Bailey, amounting in all to the sum of One hundred and fifty thousand
Dollars, all of same date for the sum of One thousand Dollars each, numbered from one to one hundred and fifty inclusive and is secured by a first mortgage
without discrimination or preference, duly executed by the said William E. Bailey, to the said Philadelphia Mortgage and Trust Company upon all that
certain tract, piece, or parcel of land, situated in the City of Seattle, King County, State of Washington, described as follows, to wit: Lots numbered two and three
in Block number Four, in plat of the town, now City of Seattle, as laid out by Boren and Dennys Plat, said lots having a total frontage of One hundred and
twenty feet on Second Street and extending backwards of that uniform width, one hundred and eight feet to an alley, according to the plat, recorded in the
records of King County, Washington Territory, in Volume "A" of Deeds, page number one, rerecorded by order of County Commis-
sioners in Plat book, March 18th 1875.

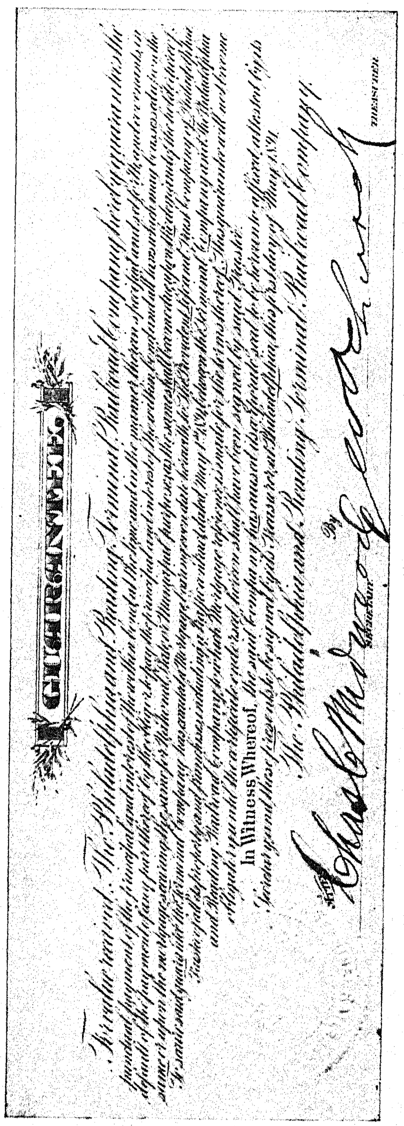
In Witness whereof, I have hereunto set my hand and seal this First day of November A.D. One thousand eight hundred and ninety.

In the presence of

This is a personal security in the nature of a guarantee, which is added to the credit contract or bond. This particular bond also has lien security in the nature of a trust deed and a sinking fund. The contract made by the Reading Terminal Company, guaranteeing payment of Reading Railroad Company bonds issued for funds with which to build the depot at Philadelphia, is exhibited on this page.

Indorsement of a negotiable bond carries with it the same significance as indorsement on a note. It may, however, be qualified by writing in any manner agreed on by the parties. The form of indorsement found on the back of the bonds taken and sold by the Philadelphia Mortgage and Trust Company, before referred to (page 168), is reproduced on page 172.

When the company wishes to assign a bond



GUARANTEED

In Witness Whereof,

The Philadelphia and Reading Terminal Railroad Company

By

President

Treasurer

without being bound as an indorser or guarantor, another form of indorsement is used. It may be assigned without recourse, or may specifically limit its liability.

*Trustee of bond security.*

A mortgage security given for the payment of a bond issue is usually executed to a trustee—some disinterested party who holds the security for the benefit of all concerned. This becomes necessary from the fact that the bonds are held by a number of persons; all of them are interested in a common security. If one of the bondholders were to hold the mort-

> *For Value Received the Philadelphia Mortgage and Trust Company hereby assigns the within bond to*
> *or order, without recourse, save that it guarantees First: The prompt payment of interest thereon, according to the tenor of coupons hereto attached, until the principal is full paid.*
> *Second: The payment of the principal within two years from maturity.*
> *Provided: That if at any time the said Philadelphia Mortgage and Trust Company shall tender the legal holder of said bond, the amount unpaid thereon with int— the said holder shall thereupon endorse and deliver said bond together with mortgage securing same properly assigned to the Philadelphia Mortgage and Trust Company, or if the legal holder shall elect not to do so, then this guarantee shall become and thenceforth be null and void.*
>
> *In Witness whereof the said the Philadelphia Mortgage and Trust Company has caused its corporate seal duly attested, to be hereunto affixed this*
> *day of in the year of our Lord, One thousand*
> *eight hundred and*
>
> *Philadelphia Mortgage and Trust Company*
>
> *Sealed and delivered in presence of*
>
> *By*
>
> *President*
>
> *Attest*
>
> *Secretary*

gage he might derive an undue advantage over other holders. Such an arrangement would deprive a bond issue of its special advantage. The rights of all parties are protected by making some disinterested person trustee for the purpose of holding and administering the security.

Since the trust company has come to be a prominent feature of financial life, it is the usual thing to have mortgage security of a bond issue made to such a company in trust. It is from this class of relations that the trust company derives a large part of its business. Any one who is capable of receiving title to property, however, may become a trustee. It sometimes happens that one of the bondholders will hold the mortgage for himself and all others. This makes him responsible as trustee to the other bondholders.

*Who may be trustee of a bond issue.*

Very often stocks, as well as bonds, are called "securities." On this account it may be well to distinguish between corporate shares and corporate bonds. The corporate share is a certificate of proportionate proprietary interest in a corporation—that is, it is received in exchange for contributions of funds made by a proprietor. The bond, on the other hand, is a credit obligation of the company. The stockholder stands in much the same relation to a corporation as does a partner to an unincorporated company—i. e., he is a joint owner of the concern. The bondholder, however, has no interest in the company; he simply holds a contract which binds the corporation to pay him a definite sum of money. The bondholder usually has some kind of security for the fulfilment of his contract; the stockholder has no security, and can have none, (1) because his contract is not one for the payment of a definite sum of money; (2) because his income, as a proprietor, can be nothing but a share in the dividends declared out of the profits of the company after the payment of all credit demands.

*How corporate bonds differ from corporate shares.*

## Definition and Classification of Corporate Bonds

With reference to the nature of security, corporate bonds fall under two classes, each of which has several subdivisions. Those which are based on personal security are either

"guaranteed" bonds or "indorsed" bonds. These have been discussed and distinguished at such length that nothing further need be said except to call attention to the fact that they form a part of the classification determined by the nature of the security offered.

*Guaranteed and indorsed bonds.*

The different kinds of bonds based on lien security are numerous. Many of these take their names from the character of the property against which the lien runs. Among the most commonly found upon the market are the following:

*Bonds based on lien security.*

It may happen that a corporation will have large holdings of real estate which may be separated from its other properties. Many of the railroads have received land grants from the Government, and desiring to use these lands as a basis for security instead of selling them, a separate issue of bonds has been made upon the real estate as security. They are called real-estate bonds, to distinguish them from the other bonds issued by the company having a different kind of lien security to assure payment.

1. *Real-estate bonds.*

Instead of dividing the property, however, and issuing one kind of bonds on the security of one property, and another issue on another property, an issue may be made the security for which is a mortgage on all of the properties of the corporation. This is commonly called a "general mortgage" (page 175).

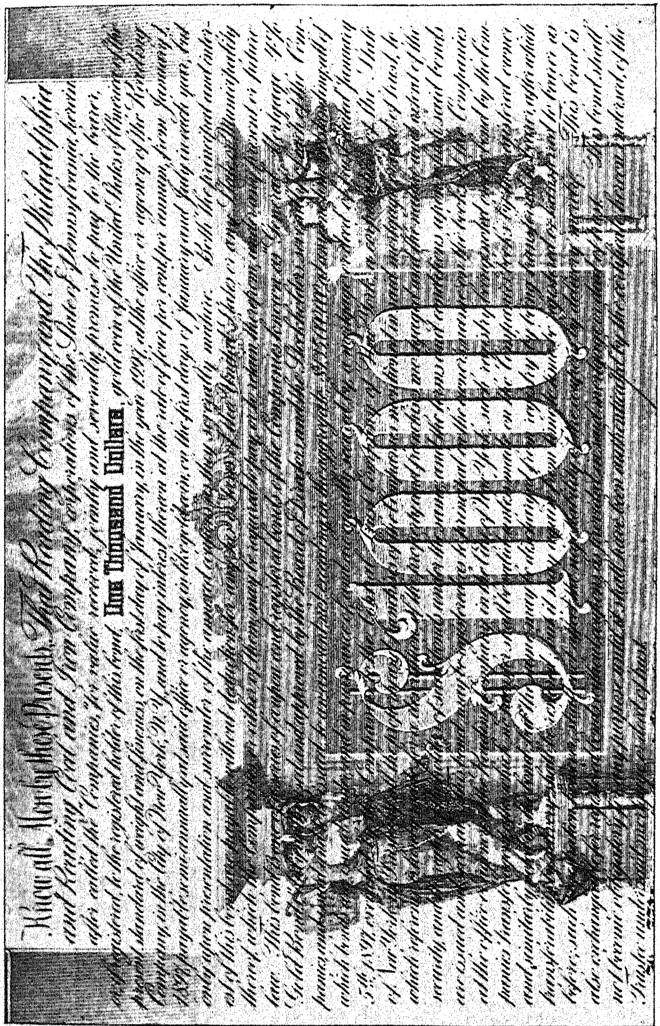
2. *General mortgage bond.*

If mortgages have already been given on particular parts, and subsequently another mortgage is given for the security of a new issue covering the whole property, the new general mortgage is called a "blanket mortgage." That is, it is a mortgage which covers the properties held as security for the payment of all previous issues.

3. *Blanket mortgage.*

Several independent properties or corporations may be consolidated. Each of these companies consolidated has

creditors to be paid, and the new company has need for new funds. In order to provide for the redemption of



bonds outstanding against the old companies, as well as for financing the needs of the new one, the whole debt is consolidated and bonds are issued under a common security to this end. A consolidated bond, therefore, is one of an issue secured by a general mortgage on properties consolidated, the purpose of the issue being that of refunding the outstanding obligations of the several concerns combined.

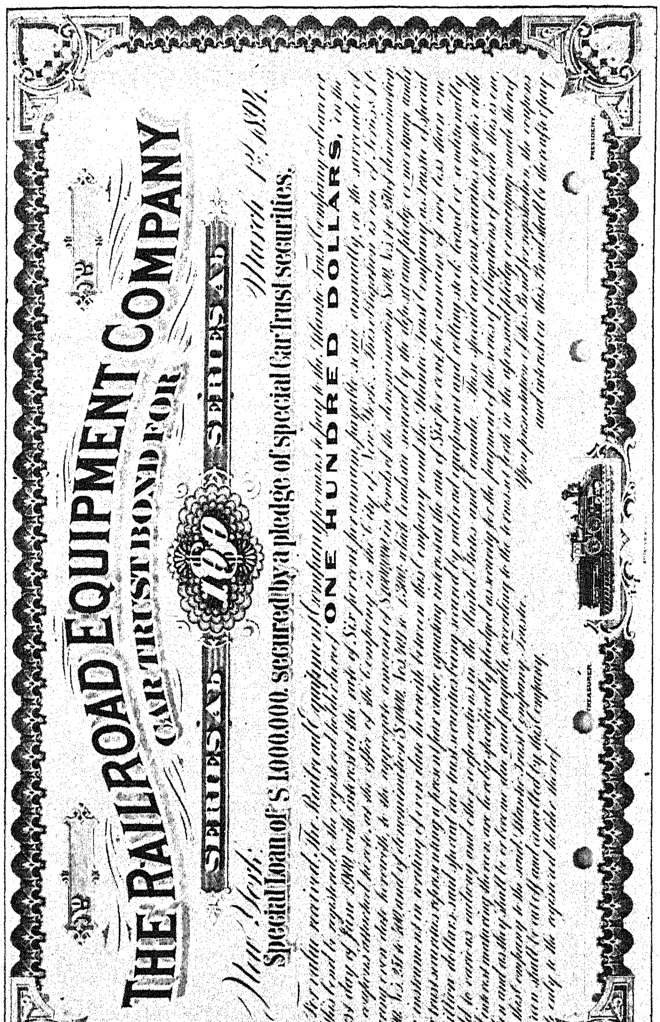
*4. Consolidated mortgage.*

A large system of railroads is commonly made up by consolidating or uniting a number of smaller companies. The New York Central was organized in 1854 as a consolidation of seven or eight short local lines running along the Erie Canal. The Pennsylvania system is made up of a large number of smaller systems. The New York, New Haven & Hartford is another example of this kind. When these consolidations are made there are usually several bond issues already outstanding on the several roads that enter into and become a part of the new consolidated system. These old roads become divisions of the new system, and their separate outstanding bonds are called "divisional bonds." The term applies to railroad bonds of this kind alone.

*5. Divisional bonds.*

The bonds so far discussed have had for security a mortgage on some form of real property. Very often the bond issue is based on personal property. One of the most common of this class is the collateral trust bond. This is the same as a collateral note, except that the whole issue has for security other stocks, bonds, or mortgages placed in the hands of a trustee under a contract which provides for their sale. These securities are placed in trust for the payment of principal and interest. They may be sold and the proceeds applied in case of failure of the one issuing the bonds to make payment at the time that interest or principal of the issue becomes due. These contracts of trust, or collateral security, usually allow the maker to substitute securities of equal

*6. Collateral trust bond.*


THE RAILROAD EQUIPMENT COMPANY
CAR TRUST BOND FOR
100
SERIES A.D.
New York, March 1st 1891.
Special Loan of $1,000,000. secured by a pledge of Special Car Trust securities.
ONE HUNDRED DOLLARS,

value in case he wishes to use or dispose of any part of those originally deposited; such substitution, however, is subject to the discretion of the trustee.

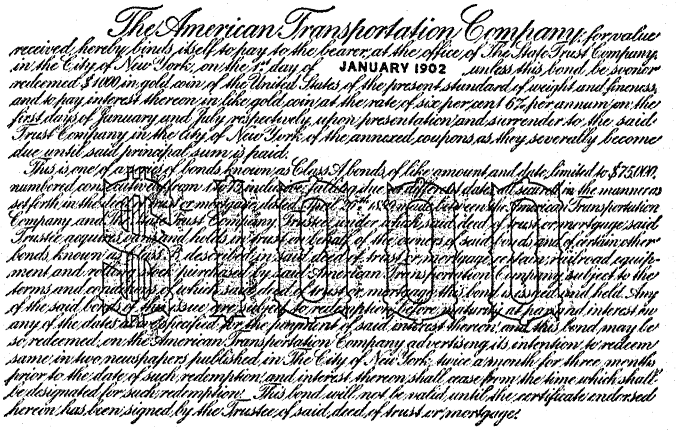
Another form of bond, the security for the payment of which is a mortgage on personal property, is what is known as an equipment bond. A company wishes to purchase machinery or equipment. It has not funds enough to pay for the amount needed. The company therefore makes an arrangement with a manufacturer of equipment, or some company having machinery to sell, to take bonds, secured by a mortgage on the machines purchased, in payment. This is one of the devices commonly employed in buying "rolling-stock" for railroads and machinery for manufacturing plants. The bonds run for a comparatively short time, and usually bear a good rate of interest.

*7. Equipment bond.*

One of the most highly specialized forms of railroad securities is what is known as the car-trust bond. This is quite different in form from all other classes of bond obligations. The car-trust, as it is called, is a concern which purchases cars from a manufacturer. It will then sell them to a railroad on the instalment plan. Or, to speak more strictly, the car-trust will lease the cars to the railroad under an agreement which provides that when the railroad company has paid a certain amount of rent the railroad company shall become the owner of the cars, but until such time the car-trust shall own them. Let us suppose that the Ontario & Western Railroad should arrange with the Central Car-Trust for $100,000 worth of cars. It might be provided that the Ontario & Western would pay $5,000 per month as rent, and that when it should have paid twenty months' rent at $5,000 per month it would own the cars. The car-trust bond is simply the obligation given by the car-trust company, the security for which is the cars rented to the railroad, the payment on the bonds being secured by payments of rent. The form of

*8. Car-trust bonds.*

car-trust issued by the American Transportation Company is reproduced here in line engraving:



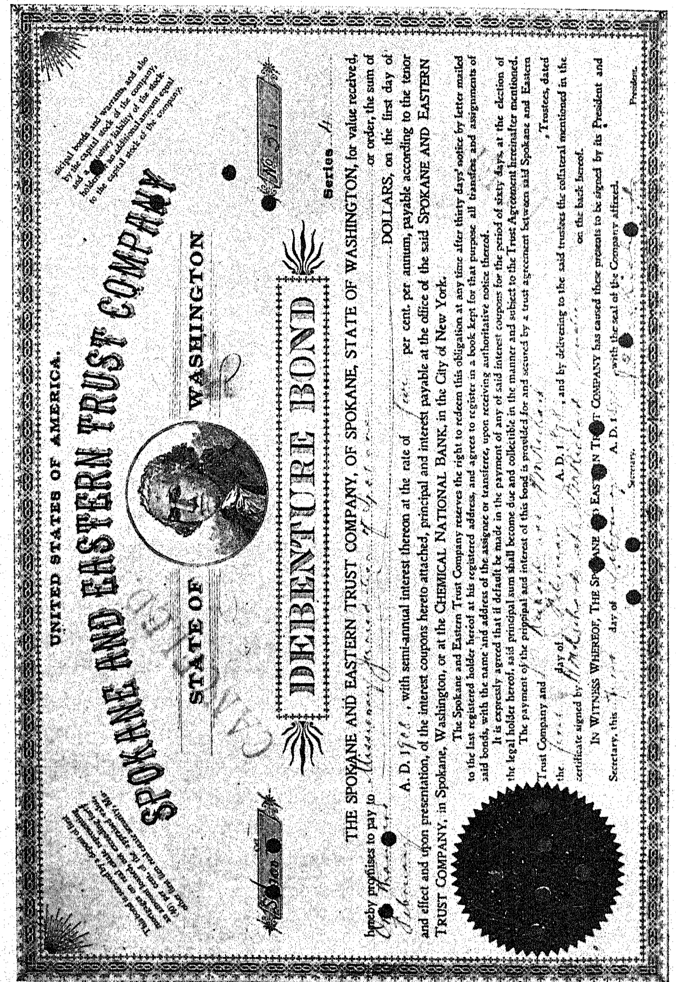
The American Transportation Company, for value received hereby binds itself to pay to the bearer, at the office of The State Trust Company in the City of New York, on the 1st day of JANUARY 1902 unless this bond be sooner redeemed $1000 in gold coin of the United States of the present standard of weight and fineness, and to pay interest thereon in like gold coin at the rate of six per cent 6% per annum on the first days of January and July respectively, upon presentation and surrender to the said Trust Company in the City of New York of the annexed coupons as they severally become due until said principal sum is paid.

This is one of a series of bonds known as Class A bonds of like amount and date, limited to $750,000, numbered consecutively from 1 to [illegible] inclusive, falling due at different dates, all secured in the manner as set forth in the deed of trust or mortgage dated April 20th 18[illegible] made between the American Transportation Company and The State Trust Company, Trustee, under which said deed of trust or mortgage said Trustee acquires, owns and holds in trust on behalf of the owners of said bonds and of certain other bonds known as Class B, described in said deed of trust or mortgage, certain railroad equipment and rolling stock purchased by said American Transportation Company subject to the terms and conditions of which said deed of trust or mortgage this bond is issued and held. Any of the said bonds of this issue are subject to redemption before maturity at par and interest on any of the dates also specified for the payment of said interest thereon, and this bond may be so redeemed on the American Transportation Company advertising its intention to redeem same in two newspapers published in The City of New York, twice a month for three months prior to the date of such redemption, and interest thereon shall cease from the time which shall be designated for such redemption. This bond will not be valid until the certificate endorsed hereon has been signed by the Trustee of said deed of trust or mortgage.

The term debenture bond is the most loosely used of any of the terms descriptive or suggestive of financial instruments. Debenture means debt, and might be applied logically to any kind of a credit instrument. Its uses, however, have come to be quite strictly defined in certain financial relations. The "debenture bond" of a financial company is a form of collateral trust or credit obligation, secured by deposit of bonds and mortgages owned by the company. These "debentures" are used to obtain funds for permanent use in the purchase of other bonds and mortgages, which may again be used as a security for a further "debenture" issue. A facsimile copy of such a bond issue by the Spokane and Eastern Trust Company of Spokane, Washington, is given on page 180. From a reading of the contract printed across the upper corners of the instrument referred to it will appear that "this bond is secured by a deposit of first mortgages on real estate representing an amount loaned, not exceeding forty (40) per cent.

*9. Debenture bonds of financial companies.*

of the appraised value, other first lien real-estate security, municipal bonds and warrants," etc. A schedule or list of


UNITED STATES OF AMERICA.

SPOKANE AND EASTERN TRUST COMPANY

STATE OF WASHINGTON

This bond is secured by a deposit of first mortgages on real estate representing an amount loaned not exceeding forty (40) per cent. of the appraised value, other first lien real estate security, municipal bonds and warrants, and also by the capital stock of the company, and a statutory liability of the stockholders in an additional amount equal to the capital stock of the company.

CANCELLED

DEBENTURE BOND

No. 31

Series A

THE SPOKANE AND EASTERN TRUST COMPANY, OF SPOKANE, STATE OF WASHINGTON, for value received, hereby promises to pay to ........ or order, the sum of ........ DOLLARS, on the first day of ........ A. D. 1908, with semi-annual interest thereon at the rate of five per cent. per annum, payable according to the tenor and effect and upon presentation, of the interest coupons hereto attached, principal and interest payable at the office of the said SPOKANE AND EASTERN TRUST COMPANY, in Spokane, Washington, or at the CHEMICAL NATIONAL BANK, in the City of New York.

The Spokane and Eastern Trust Company reserves the right to redeem this obligation at any time after thirty days' notice by letter mailed to the last registered holder hereof at his registered address, and agrees to register in a book kept for that purpose all transfers and assignments of said bonds, with the name and address of the assignee or transferee, upon receiving authoritative notice thereof.

It is expressly agreed that if default be made in the payment of any of said interest coupons for the period of sixty days, at the election of the legal holder hereof, said principal sum shall become due and collectible in the manner and subject to the Trust Agreement hereinafter mentioned.

The payment of the principal and interest of this bond is provided for and secured by a trust agreement between said Spokane and Eastern Trust Company and ........, Trustees, dated the ........ day of ........ A. D. 1898, and by delivering to the said trustees the collateral mentioned in the certificate signed by ........ on the back hereof.

IN WITNESS WHEREOF, THE SPOKANE AND EASTERN TRUST COMPANY has caused these presents to be signed by its President and Secretary, this ........ day of ........ A. D. 1...., with the seal of the Company affixed.

Secretary. President.

the documents deposited in trust for the benefit of the bondholders, is indorsed on the back of each bond. The de-

bentures of financial companies are regarded as first-class investments. They are to be clearly distinguished from railroad debentures.

10. *Railroad debenture bonds.* Railroad companies issue a form of bond called a "debenture" which is quite different in character. These bonds very often have no security for the payment of interest; many times the principal also is unsecured. The payment of interest is dependent on the surplus net earnings of the road. Instead of being a first lien on the properties and incomes of the road, they are a last claim, and stand in a rank inferior to all other bonds of the company; they are in some respects inferior to the unsecured short-time credit obligations of the road; they lack the advantage of paper maturing at an early date, and have little or no advantage from contracts of security.

11. *Income bonds.* An income bond is one the interest on which is payable out of the surplus net earnings of the company issuing it. The interest therefore is contingent on a remainder of earnings after the payment of all expenses, cost of maintenance, taxes, interest, rentals, and other fixed charges. If there be nothing left, then the company is under no obligation to pay interest for the year. The interest, however, may be made cumulative —that is, while there is no obligation to pay interest if there be no funds with which to do so, yet the amount of interest contracted for cumulates as a charge which stands ahead of all dividends on the common or preferred stock. The income bond usually has the payment of the principal secured by a mortgage, which, although junior to other mortgages, gives to the income bondholder a rank ahead of the general, unsecured, creditor (see page 182).

Other bonds take their names from the purpose of the issue, as, for example, the Purchase-Money Bonds issued in substitution for the indebtedness of the Virginia Central Railroad Company (page 184). In 1878 the Chesapeake & Ohio got control of the Virginia Central and arranged a consolida-

UNITED STATES OF AMERICA

STATE OF NEW YORK.

# Rider & Driver PUBLISHING COMPANY.

## INCOME GOLD BOND.

KNOW ALL MEN BY THESE PRESENTS,

NUMBER

DOLLARS 500.

That Rider & Driver Publishing Company, a corporation organized and existing under the laws of the State of New York (hereinafter called "the Corporation"), for value received promises to pay to the bearer, or if registered, to the registered holder of this bond, FIVE HUNDRED DOLLARS, in gold coin of the United States of America of the present standard of weight and fineness on the 1st day of September, 1921, at the office or agency of the Corporation in the city and state of New York, and to pay interest thereon at said office or agency in like gold coin, as hereinafter provided.

In the month of July in each year the Board of Directors of the Corporation shall ascertain and determine the amount of the net earnings of the Corporation for the preceding twelve months, over and above the expenses of operation and maintenance and fixed charges for such period of twelve months, and such net earnings shall be applied to the payment of interest on this bond at a rate not to exceed five per centum (5%) per annum, but no interest shall become or be due or payable hereon in respect of any year in which the net earnings of the Corporation over and above all the necessary expenses of operation and maintenance and fixed charges shall not be sufficient to pay the same.

No dividends for any year shall be paid upon the stock of the Corporation until interest at the rate of five per cent (5%) for that year shall have been paid upon the Income Gold Bonds.

Both the principal and interest of this Bond are payable without deduction for any tax or taxes of the United States or of the State of New York, or of any municipality thereof, which the Corporation may be required to pay or to retain therefrom under any present or future law.

This bond is one of a series of Bonds of the Corporation known as Income Gold Bonds, duly authorized and approved by the Directors of the Corporation, issued and to be issued, but so that the aggregate amount of such Income Gold Bonds at any time outstanding shall never exceed the total sum of One Hundred Thousand Dollars.

The Corporation shall have the right to call in and pay off any or all of said Income Gold Bonds upon the 1st day of September in any year during the period of this bond upon payment therefor of one hundred and five per cent. of their par value of principal, provided that notice of the intention so to do shall be given by publication in two newspapers of general circulation, published in the City of New York, once in each week for three weeks, the first publication to be at least two months before the day designated for such payment, and no interest hereon from and after the day so designated shall be due or payable.

This bond may be registered in the owner's name on the books of the Corporation at its office or agency in the City of New York, such registration being noted on the bond by the Corporation or its transfer agent, after which no transfer shall be valid unless made on the Corporation's books by the registered owner and similarly noted on the bond, but the same may be discharged from registry by being transferred to bearer, after which transferability by delivery shall be restored, but it may again from time to time be registered or transferred to bearer as before.

In case this bond shall not be registered, payments of interest thereon shall be evidenced by stamping hereon the date and the amount of payment.

In Witness Whereof, the Corporation has caused these presents to be subscribed by its ______ President, and its corporate seal, duly attested by its Secretary, to be hereunto affixed, this ______ day of ______ 190

______ PRESIDENT.

______ SECRETARY.

tion whereby the securities of the contested road were taken up and replaced by the credit securities of the larger corporation. To this end, and as a means of securing funds with which to cancel those which could not be exchanged, the issue was made. Exhibit is also given (page 186) of the Improvement bonds of the Philadelphia & Reading. These are issued for the purpose of financing the enormous coal properties purchased in the '70s, and for improving the equipment of the road for handling its increased business. The bond here shown is an old one; it has been through four receiverships and reorganizations—has been subject to all the financial extremities of that great system whose destiny has been linked with the development and manipulations of the anthracite coal regions of Pennsylvania.

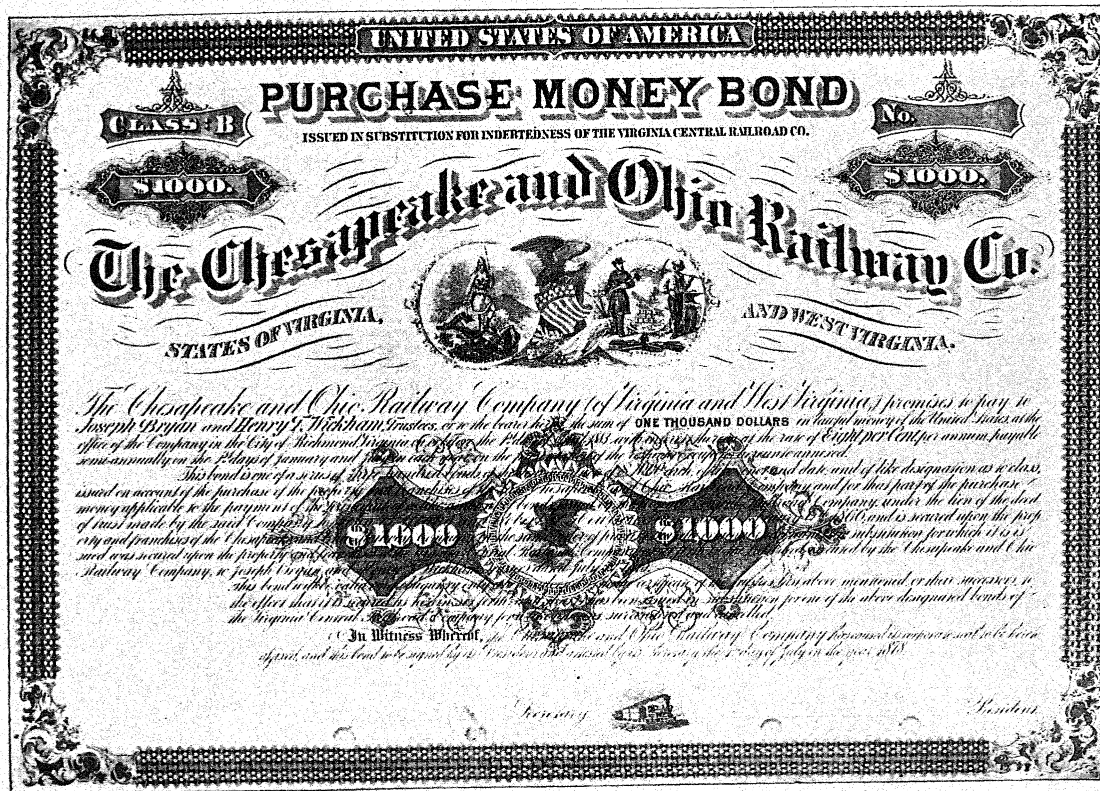
*Bonds classified according to their purpose.*

Bonds also differ in the contracts of payment. The contract may be for the payment of gold coin of the United States, of present weight and fineness, in which case they are called "gold bonds." They may be made payable in any form of money that is legal tender for the payment of debts. These are called legal-tender bonds. With reference to the form of contract for the payment of principal and interest, there are two classes: (1) coupon bonds and (2) registered bonds. A coupon bond is usually made payable to bearer, and the interest payments are represented by separate interest notes attached to the principal obligation. When a coupon becomes due, the holder of the bond will "clip" or cut off the coupon which has matured and present it for payment in the same manner as other notes are presented. This is usually done by "depositing" it at the bank where the holder does his business; the bank will receive it "on account" and send it to the office of the company or to the bank where the company does its business. The registered bond, on the other

*Gold bonds.*

*Legal-tender bonds.*

*Coupon bond distinguished from registered bond.*



UNITED STATES OF AMERICA

PURCHASE MONEY BOND

CLASS B

No.

ISSUED IN SUBSTITUTION FOR INDEBTEDNESS OF THE VIRGINIA CENTRAL RAILROAD CO.

$1000. $1000.

The Chesapeake and Ohio Railway Co.

STATES OF VIRGINIA, AND WEST VIRGINIA.

The Chesapeake and Ohio Railway Company (of Virginia and West Virginia) promises to pay to Joseph Bryan and Henry T. Wickham, Trustees, or to the bearer hereof the sum of ONE THOUSAND DOLLARS in lawful money of the United States at the office of the Company in the City of Richmond, Virginia, on or after the 1st day of [illegible] 1883, with interest thereon at the rate of Eight per Cent per annum payable semi-annually on the 1st days of January and July in each year, on the [illegible] of the [illegible] coupons hereunto annexed.

This bond is one of a series of three hundred bonds of [illegible] each, of [illegible] and date and of like designation as to class, issued on account of the purchase of the property and franchises of the [illegible] Ohio Railroad Company and for that part of the purchase money applicable to the payment of the [illegible] Company, under the lien of the deed of trust made by the said Company [illegible] 1860, and is secured upon the property and franchises of the Chesapeake [illegible] substitution for which it is issued was secured upon the property and franchises of the [illegible] Central Railroad Company [illegible] by the Chesapeake and Ohio Railway Company, to Joseph Bryan and Henry [illegible] Wickham, Trustees, dated July [illegible] this bond will be valid [illegible] the trustees herein above mentioned, or their successors, to the effect that it is [illegible] forth [illegible] one of the above designated bonds of the Virginia Central Railroad Company [illegible] surrendered and cancelled.

In Witness Whereof, the Chesapeake and Ohio Railway Company has caused its corporate seal to be hereto affixed, and this bond to be signed by its President and attested by its Secretary, the 1st day of July in the year 1868.

$1000 $1000

Secretary. President.

hand, has no separate contract for the payment of interest. In order that the company may know to whom interest is due, the owner is required to register the bond with his name and address at the office of the company or at the office of an agreed financial agent. Then the payment will be made by a check, the company remitting interest to the registered holder when interest comes due.

*Redeemable bonds.*

Bonds may also have a provision made for payment before the time of maturity, at the option of the maker. For example, a twenty-year bond may be made payable at the end of ten years if the maker so elect; or a fifty-year bond may be made payable after twenty-five years, and on the 1st of January each five years thereafter, if the maker so elect. This prevents the creditor making demand before the ultimate time of maturity, but gives to the debtor the right to pay his debt before maturity.

*Convertible bonds.*

Other classes of bonds take their names from the special privileges granted to the owner or holder. Convertible bonds are credit obligations which may be converted into some other form of liability. That is to say, a mortgage bond may give to the holder the right to convert his holding into preferred stock, or a divisional bond may be made convertible into a consolidated mortgage bond.

*Payment and extension of bonds.*

Like a promissory note, a bond may be canceled by payment. Being a contract for the future delivery of money, the contract is fulfilled when the money is delivered according to the tenor of the agreement. It sometimes happens, however, that the maker, or one issuing the bond, is unable to fulfil its conditions. Then the only remedy is "settlement." A settlement may be effected by judicial procedure or voluntarily between the parties. By judicial procedure, the property on which the lien contract of security is held may be sold. By voluntary agreement, something other than

6 per cent Improvement Mortgage Bonds for $10,000,000 Gold, or £2,000,000 Sterling.

$1,000 Gold. £200 Sterling.

EXTENDED IN ACCORDANCE
WITH THE ANNEXED
AGREEMENT OF APRIL 1, 1897.

$1000

KNOW ALL MEN BY THESE PRESENTS, That [illegible] Rail Road Company incorporated under the laws of Pennsylvania, in the United States of America, [illegible] the sum of TWO HUNDRED POUNDS British sterling, or ONE THOUSAND DOLLARS in gold coin of the United States of America, which sum the said Company promises to pay to the bearer hereof on the first day of October in the year one thousand eight hundred and ninety seven, or at such earlier day as hereinafter mentioned, on this bond being duly drawn for payment, with interest thereon from the first day of October, one thousand eight hundred and seventy three, at the rate of 6 per cent. per annum, payable half yearly on the first days of April and October respectively in each year, upon presentation and surrender of the annexed coupons as they severally become due; the said principal and interest to be respectively paid, at the option of the holder of the bond or coupons, in British sterling money at the offices of Messrs. McCalmont Brothers & Co. in London, or in United States gold coin at the office of the Company in the City of Philadelphia; and in each case without deduction from the said principal or interest of any tax which may be payable on account thereof, under any law of the United States or any of the States thereof, now existing or hereafter to be enacted, the payment of all such taxes being assumed by said Company in addition thereto.

This bond is one of a series of 10,000 bonds of like date, tenor and amount, numbered consecutively from 1 to 10,000 inclusively, and amounting in the aggregate to $10,000,000 gold, or £2,000,000 sterling, and the payment whereof is equally secured by a mortgage, dated October 1st 1873, duly executed and delivered by the said Company to The Pennsylvania Company for Insurances on Lives and Granting Annuities, as trustees for the benefit of the bondholders, to the provisions of which mortgage this bond is subject, and which mortgage creates an accumulative sinking fund for the redemption of the said bonds, by which the whole of the bonds constituting this issue will be redeemed in twenty four years, according to the table printed on the back hereof, which sinking fund is to be applied by the trustees in the redemption of the said bonds at their par value.

The bonds to be redeemed each year are to be drawn by lot under the direction of the trustees, in the month of July, the first drawing to take place in July 1874, at the office of Messrs. McCalmont Brothers & Co. in the city of London, and on the first day of October following the principal of each bond so drawn shall be payable, at the option of the holder, at the offices and in the manner aforesaid, upon the surrender of the drawn bond with all the coupons belonging thereto, and after the said first day of October the interest upon bonds so drawn shall cease.

This bond is not to become obligatory upon the Company until the certificate endorsed hereon is signed by the trustees.

In Witness Whereof, The said Company has caused its corporate seal to be hereto affixed and the same to be attested by the signature of its proper officers and has also caused the coupons hereto annexed to be signed by its Secretary, the first day of October, one thousand eight hundred and seventy three.

D. J. Munn Secretary

G. A. Nicolls for President

money payment may be taken, or an "extension" may be made. A contract of extension is shown on page 188. This contract is between the Reading Company (a security-holding concern) and the Philadelphia & Reading Railroad.

### Receivers' Certificates

In a corporation to which so many have made contributions of funds—a company whose proprietors are divided into classes (common and preferred), and whose creditors have distinct rights and opposing interests—controversies very often arise which require the interference of courts to protect the rights of parties concerned. The property is usually in the possession of the officers of the company as representatives of the stockholders. When controversies arise, the parties in possession control the earnings and incomes; they therefore have a marked advantage. The earnings of the Pennsylvania Railroad, for example, amount to nearly $100,000,000 per year. The entire stock interest is only $150,000,000. Let us suppose that those in possession represent only $80,000,000 of the stockholdings. During a year they might divert enough current income to repay the entire amount of the investment, while the other stockholders and the creditors would be entirely deprived of revenue. It often happens that a controversy will last several years. To leave the property in the hands of any party in interest might prove ruinous to all others. As a means of preventing injustices of this kind, the court to which the controversy is referred will appoint an officer of its own—some one responsible to the court—to receive the property of the corporation and manage it pending litigation. Such an officer is called a receiver.

Litigation involves expense. When parties appeal to the courts for adjudication of rights and claims, the costs become a first charge on the property. Court costs are always

# EXTENSION CONTRACT.

By and in consideration of this contract and coupon sheet made by the Philadelphia and Reading Railway Company and attached to the accompanying bond No. 7388 given by its predecessor The Philadelphia and Reading Railroad Company, dated October 1, 1873, and their acceptance by the holder, the Philadelphia and Reading Railway Company, and the Reading Company (the owner of the capital stock of the said Railway Company) and the holder of this bond agree that the principal of said bond shall not be payable nor shall payment thereof be required before the first of April 1947, unless default be made in the payment of the interest at the rate of Four per centum per annum, after presentation of the several proper semi annual coupons for $20 each, which coupons the said Philadelphia and Reading Railway Company and the Reading Company jointly and severally promise to pay on presentation at the office of the Railway Company, but on any such default said principal, at the option of the holder, will thereupon forthwith become and be due and payable. This extension at the reduced rate of interest is made and accepted upon condition that payment of the principal and interest of such bond, as extended, shall be made in United States gold coin of the present standard of weight and fineness, without deduction for any taxes imposed by the United States or the State of Pennsylvania which the Company may lawfully be required to retain therefrom, and for the further security of the holder hereof the Reading Company covenants that such payment of principal shall be made upon April 1, 1947.

The security of said bond remains unimpaired, and no part of this contract shall be construed to affect its priority or validity, or the rights and powers of the Trustee.

In Witness Whereof, The said Companies have caused their respective corporate seals to be hereunto affixed, duly attested, the first day of April, 1897.

| Reading Company | Philadelphia and Reading Railway Company |
| --- | --- |
| By ______ Vice President. | By ______ President. |
| Attest ______ Secretary. | Attest ______ Secretary. |

the first claims paid. The expenses of receivership are in the nature of court costs. In the management of a railroad the receiver may be required to obtain millions of dollars to pay for operation, maintenance, supplies, etc., and to meet current demands. To obtain these funds the receiver issues a special kind of credit obligation known as a receiver's certificate. These are very often issued in uniform amounts and in series, so that they appear in the form of bonds. But although they have no contracts of security for payment, by virtue of their being issued for court costs, they are a prior lien on all the assets and incomes of the company.

*Security of receivers' certificates.*

The financial advantage of the receiver's certificate to the business concern for the operation of which it is used is apparent. By its use the receiver is enabled to obtain funds when the officers of the company can not. Quite as marked are the advantages to the purchasers of the certificates. By obtaining a first lien on the property the holders may force all other claimants to terms, and even drive a first-mortgage bondholder to settle. This brings the parties to the conflict to an adjustment of interests, when otherwise a settlement could not be reached except by selling out and winding up the affairs of the company.

*The advantages of receivers' certificates.*

### The Lease—its Relations to Finance

A lease is a contract entered into which allows one person, called the lessee, to use the property owned by another, called the lessor. Brown wishes to engage in the business of manufacture of cotton cloth. Jones has a factory which will suit Brown's purpose. Jones will sell the factory for $100,000. Brown has not the funds to purchase the factory. His capital is limited to $50,000, and he will need this to run the plant. Brown proposes a plan whereby he can obtain the use of the factory, and pay for its use out of

earnings. He offers $10,000 per year to Jones for the use of the plant, the amount to be paid as follows: $5,000 in six months and $5,000 one year hence. This Jones accepts. The use of the lease is plain. It avoids the necessity of raising funds with which to purchase that part of Brown's business equipment. Instead of the factory being a capital asset, and the funds represented as a liability, the rent becomes a fixed charge against the net earnings from operation. The value of the lease is, that it makes it possible for Brown to obtain a business equipment without raising additional funds.

*The lease as security.*

Credit transactions are carried on under the guise of a lease. The use of the lease by a railroad as security for the purchase of cars has been described under the title "Car-trust Bonds." The same principle is employed in sales "on the instalment plan." One wishes to purchase a piano. The price is $500. This may be paid for at $10 per month. Instead of the seller taking a note with a mortgage on the piano as security for the payment of the note, he leases the piano to the purchaser for $10 per month, the agreement being that when the purchaser has paid $500 in rent he shall become the owner.

*The uses of the lease by credit stores.*

Some merchants make a special feature of sales on credit secured in this way. They advertise extensively, asking people of small means, laboring men, etc., to deal with them on credit. Instead of making a direct sale, however, they simply lease the cook-stove, the carpet, the wall-hangings, the crockery, etc., and retain the title to the goods; they collect rents till an agreed amount has been paid, when the merchant gives the title to the purchaser. This allows a man without accumulated funds to set up an establishment, and surround himself with comforts of life which otherwise he could not afford. He is limited only by his inability to pay the rent.

While the lease gives to the merchant the best security possible, it threatens the purchaser with loss of the goods and all previous payments on them in case of default of one rent payment. In the case of the piano purchase above referred to, the purchaser may have paid $450 in rents, at $10 per month, and have still only a $50 balance before the title would pass, but failure to make the next month's payment would give to the owner (the piano dealer) the right to take the instrument away, and confiscate the whole amount paid in. This is the method commonly employed by company stores in the mining districts. The miner can get what he will within the limits of the judgment of the company storekeeper as to the ability of the employee to make payments of rent. But the laborer stands in constant danger of losing his all by having his wages stopped for a month.

*Dangers of lease purchases.*

PART III

# INSTITUTIONS AND AGENTS USED IN FUNDING OPERATIONS

## CHAPTER IX

### THE UNITED STATES TREASURY

THE Government stands in a double relation to modern systems of finance. In the first place, it must provide a uniform system of money; in the second place, it must give attention to its own financial needs—must arrange for its own support. The first we may call its money function; the second its fiscal function. In this study it is its money functions with which we have to deal—its fiscal relations belonging to the realm of public finance. With a primitive people, formal acts of Government may not be necessary to the choice or use of a common commodity as money; out of expediency a general practice may grow up; commodities which in their nature may be used as a common standard for the comparison of value (such as cattle or furs) may serve the purpose of exchange. But those substances which best lend themselves to the more exact judgment necessary to broad and complex commercial relations, have not the marks of individuality and of quality stamped on them by nature—such as are common to cattle, or furs, or wheat. The trader, therefore, may not so easily protect himself against deception and loss. For example: One of the characteristics that makes gold so serviceable as money is the high value imputed to small quantities of the metal; another is the exact uniformity of weight and quality that can be given to each piece. But these divisions and refinements are

*Relations of Government to modern systems of finance.*

*Need for coined money.*

purely artificial; by nature they have not uniformity; they have no individual completeness as have cattle or furs, and a few grains added to or taken from a piece of gold may so materially affect its value as to destroy the serviceability of a coin as a standard for judgment. Some common unit of weight and fineness is essential. The parties to an exchange, being controlled by motives of gain, could not be relied on to give character to coin; the Government—the agency of the people devoted to general, as opposed to private, welfare—must give the metal official stamp, which will stand as a guarantee and protect the people against the wiles and arts of individual traders.

*1. Coinage.*

Reference has already been made to the advantages to be gained from the adoption of a single standard or unit for judgments of value in exchange. This advantage would suggest the use of a single material for money. But a single material does not serve well all of the uses of money. The necessity for carrying about and transferring such quantities of money material as will be of great value suggests the use of a "precious" metal for the larger transactions. Materials which would best serve in this capacity, however, would require such minute subdivisions for small transactions and "change" as to be wholly unpractical. Thus gold serves well the main purpose—transfers of larger value than $2.50. But the pieces representing smaller values would easily be lost, and inconvenient in use. Silver does not serve well for large exchanges because it encumbers the trader; but it is convenient and more practical than gold for transfers ranging in value from 10 cents to $2. Below this, however, silver is not a convenient money. The subdivisions necessary for smaller "change" make it impracticable, and some such metal as nickel has superior advantages until the minimum of 2 or 3 cents is reached, when a still "baser" metal is found to be more

*2. Providing for a complex system of money.*

convenient. Bronze may be subdivided to represent values of fractions of a cent, but would be too heavy for transactions of larger amount. There is economy, therefore, in a variety of metals in the money system.

*3. Maintenance of a standard.*

The practical question to the nation, and to the commercial world at large, is, How can the advantages of a single standard (or a definite unit for the judgment of value) be preserved, and at the same time the unquestionable economy of variety in our system of money? Long and bitter experience has driven men to the conclusion that there is only one solution, viz., *the establishment of a unit, or standard, in a more precious metal, and a system of redemption of all other forms of money used, at a fixed ratio.* The adoption of such a system, however, makes necessary a redemption agency, and this can be established and maintained only by act of Government. Redemption, however, has the effect of reducing all moneys, other than the standard, to forms of credit. They constitute in themselves promises to pay a definite amount of standard money according to the ratio stamped on their faces. If, for example, silver dollars are made redeemable in gold whenever a silver dollar shall be presented at a redemption agency, then every time a silver dollar is put into circulation the Government has put out, with this silver dollar, its promise to pay to bearer $1 in gold on demand; the possessor of the silver dollar holds

*By redemption of inferior coins.*

a credit obligation on the Government for the payment of $1 in gold coin of the United States stamped on silver instead of having the promise written on paper. As a credit instrument, the advantage of having the promise to pay stamped on the silver coin instead of paper is this: that it adds to the promise of the Government a collateral security equal to the value of the silver used, and on redemption of the promise the Government has this collateral for use again; this increases the assets of the Government held as the

means of meeting promises to pay gold. The gold price of silver coin increases the ability of the Government to get gold with which to meet these promises.

But the use of credit money does not logically stop with redeemable coin. If a system of money is developed whereby coins become promises of the Government to pay gold, what is there to prevent it from writing these promises on paper and passing that in payment? There is no reason at all, provided the Government at all times keeps in condition to meet these promises; and if it does not, then silver dollars or copper coins would depreciate as well. Government credit stands upon no different footing than private credit. The value of the promise depends on the judgment of the individual receiving it as to the ability of the Government to fulfil its obligations. In our system, paper money is nothing more or less than a demand obligation on the Government to pay gold on call; there must be gold available, however, so that no doubt will be entertained on this score. The only manner in which Government credit differs from private credit lies in the different methods which may be employed by the Government to obtain gold with which to pay, and this applies as well to its redeemable coin as to its paper.

*By redemption of paper money.*

The machinery with which a government must equip itself to perform its monetary functions embraces three distinct plants: (1) A mint for giving official stamp and guarantee to its coin. (2) A redemption agency for safe keeping of the reserve, and for the free interchange of the several forms of money used, as the one or the other may be considered more desirable. (3) A revenue department by means of which necessary funds may be procured to keep the reserve intact. In our own Government all three are combined in the Department of the Treasury. The Independent Treasury may be said to be the key to our whole system of finance.

*The United States Treasury.*

In this respect our monetary system is somewhat unique —enough so to warrant an account of the conditions leading to its establishment. Before the panic of 1837 and the financial depression which followed, the government had made various incorporated banks the depositories of its moneys, as well as its disbursing agents. Moreover, the banks depended on these moneys for the maintenance of their system of credit money. The first Bank of the United States was chartered in 1791, and continued in operation twenty years. In 1816 a second bank was organized by the Government of the United States under a twenty-year charter. During forty years of this period (1789–1837), therefore, the Government had a bank of its own creation.

*History of the Independent Treasury.*

At three different intervals, covering in all a period of eight years, it had to depend on State banks. The State institutions, however, were so far from the direct control of the central Government that the currency and finances of the country were left in a state of uncertainty which paralyzed industry, and seriously handicapped private as well as public transactions. The charter of the second National Bank expired in 1836, the crisis of 1837 proved fatal to State banks, and with their failure the whole system of public and private finance was involved. The Government lost through its depositories $28,101,644.91. The losses of the people through uncertainty of credit and the fluctuation of their money standard was many times greater than that of the Government. There was a general demand for a change. Van Buren had just come into office when this financial calamity occurred. In national politics he and his party represented State and local interests as opposed to central functions; they were adverse to the chartering of a third Bank of the United States. To meet the public demand for a sound and stable currency, and at the same time not to antagonize State institutions and local interests, an Independent Treasury was proposed. After three years of political contro-

versy, Van Buren's measure became a law, but so unpopular had the Administration become by reason of the financial and industrial depression of the time, that in 1840 the opposition carried the country and Harrison and Tyler were elected. The opposition was a fusion party; Harrison was the representative of the old-time Whig—a nationalist in sentiment; Tyler was the choice of the "Nullifiers," an ultra branch of the States Rights party. These two political groups—hostile to the Administration—joined forces to defeat the party in power; but when their common enemy had been overthrown (being hostile in doctrine and interest) they fell to fighting each other. The Whigs favored a central bank. Had Harrison lived, the large Whig majority in Congress, under the leadership of Clay, without doubt would have given us a different financial history. But a month after inauguration the President died, and Tyler came to be our Chief Executive. The breach between the two factions was at first not a wide one. On his accession Tyler announced his intention to carry out the policy favored by Harrison and his party. President and party agreed to repeal the provisions for the Independent Treasury and to incorporate a third Bank of the United States. But while the measure creating the bank was under conference and discussion, the breach widened, until finally open war was declared, and when the bill had passed both houses the President vetoed it. From this time on no quarter was given. The "Nullifiers," having the Administration in their own hands, but being opposed by Congress, went back to the old party whence they came. The next presidential election resulted in favor of the Democrats. Polk's administration revived the Independent Treasury scheme of Van Buren, and in 1846 it became a well-established part of our financial system.

Through the agency of the Independent Treasury our money system has gradually become a highly refined system of credit. The United States Treasury is an institution

possessed of "issue" powers far exceeding those of any bank; and the reserve required is smaller in proportion to circulation. Only one successful bank ever approached it — the Bank of Amsterdam — and that ignominiously failed when the veil of secrecy was drawn and its reserve was made known. It is necessary only to refer to the reports of the Secretary of the Treasury to appreciate the full force of this fact. In the Treasury there is held for redemption purposes a reserve of $150,000,000 in gold. Primarily a reserve of $100,000,000 was created to give confidence in the ability and willingness of the Government to redeem its outstanding debt in the form of United States notes (greenbacks); but by the National Bank Act, and by the adoption of the gold standard, it came to be the redemption basis of our whole monetary system. On this account the amount of the reserve was increased (in 1900) to $150,000,000.

*Our money system a refined system of credit.*

Summarizing the credit moneys in circulation at the end of the fiscal year 1901, which stood as a charge against the $150,000,000 gold reserve, they appeared as follows:

| | |
|---|---|
| 1. United States notes (greenbacks) | $346,681,016.00 |
| 2. National bank-notes | 345,126,521.00 |
| 3. Silver coins in circulation | 146,287,981.00 |
| 4. Silver certificates | 435,014,000.00 |
| 5. Treasury notes of 1890 | 47,783,000.00 |
| 6. Currency certificates | ............ |
| 7. Fractional currency notes (shinplasters) | 15,252,349.96 |
| 8. Old demand notes | 53,847.50 |
| 9. One- and two-year notes | 58,535.00 |
| 10. Compound interest notes | 165,850.00 |
| 11. Minor coins (nickel and bronze) | 32,936,470.38 |
| | $1,369,359,570.84 |

Besides these several forms of money which are supported by the $150,000,000 reserve, provision was made whereby the gold coins and bullion may be deposited in the Treasury and certificates issued in like amount. Of these there were

outstanding $281,678,659, but this was considered a special deposit and not available for the redemption of other money obligations.

The transactions of the Treasury in maintaining its credit moneys at a parity with gold are illustrated in the work of the redemption agency for this year.

*Redemptions and Exchanges.*

| | |
|---|---|
| 1. United States notes | $87,862,110 |
| 2. National Bank-notes | 60,730,773 |
| 3. Silver coins: | |
| Standard dollars | 39,604,974 |
| Subsidiary silver | 37,066,500 |
| 4. Silver certificates | 151,026,473 |
| 5. Treasury notes of 1890 | 21,298,927 |
| 6. Currency certificates | ........ |
| 7. Fractional currency notes | ........ |
| 8. Old demand notes | ........ |
| 9. One- and two-year notes | ........ |
| Compound interest notes | ........ |
| 10. Minor coins (nickel and bronze) | 4,140,496 |
| Total redeemed by exchange | $401,730,253 |
| Redemption and destruction | 373,852,928 |
| National Bank-notes redeemed from the 5 per cent fund | 129,100,946 |
| | $904,684,127 |

Against the account of redemption and destruction new credit money was issued to the amount of $292,532,000.

*Redemptions of credit money during 1902.*

In exchange for the $129,100,946 bank-notes redeemed, the same amount of new bank-notes was issued. Although there were $401,730,253 paid out for redemption and exchange of forms of money other than gold coin or gold certificates, standard metal was not actually used to any great extent. In most cases exchange of one form of credit money was made for other forms of credit money. Demands for payment were met in such forms of money or credit as best suited the wishes of those making them. The amount of gold

actually paid out in the redemption of the $401,730,253, on account of redemption and exchange, was as follows:

| | |
|---|---|
| 1. United States notes | $819,415 |
| 2. National Bank-notes | 191,259 |
| 3. Silver coins: | |
| Standard dollars | 10,213 |
| Subsidiary silver | 244,782 |
| 4. Silver certificates | 99,897 |
| 5. United States Treasury notes (1890) | 562 |
| 6. Minor coins | 62,092 |
| | $1,428,220 |

At the same time (making allowance for gold certificates) there were taken in by way of exchange for other forms of money, $1,419,923 in gold, leaving a net balance of gold actually paid out during the year on this account of only $8,297. With this *net* amount of gold actually paid out of the Treasury during the year, $694,262,253 of credit money was again put back into circulation, at a par value with gold. During that year, therefore, the net gold drawn from the general fund to keep up the reserve was only about $\frac{5}{1000}$ of one per cent of the $150,000,000 held for redemption purposes.

*Gold actually used for redemptions.*

Not only are all forms of money made interchangeable by the redemption system, and $1,369,359,570.84 of credit money made to circulate at a parity with gold, but through the redemption agency our currency is kept in good condition, old and tattered bills are received and destroyed, and new bills issued in their stead.

*Maintenance of integrity of our money.*

The mint may be said to be the coin factory of the Government. It is here that gold and silver bullion is received for coinage, and mechanical processes are carried on necessary to the reduction of metals to standard fineness and to the production of legally prescribed coins. The mint service is distributed over the country in such places as will best meet the demand. In this service there are five mints and seven assay offices.

*The mint a money factory.*

The mints are located at Philadelphia, San Francisco, New Orleans, Carson City (Nevada), and Denver (Colorado). The assay offices are located at New York, Boise City (Idaho), Helena (Montana), Charlotte (North Carolina), Deadwood (South Dakota), and Seattle (Washington). According to the report, only three of the mints—those at Philadelphia, San Francisco, and New Orleans—are employed in coinage, the others receiving deposits of bullion in exchange for coin. The principal assay office is at New York. It is to be noted that the coinage plants are located conveniently near to the commercial centers, while the assay offices are in centers of metal production and importation. Minor coins are made in Philadelphia alone. In 1899 the production was as follows:

| Institutions. | Gold coinage. | Silver coinage. | Minor coinage. |
|---|---|---|---|
| Philadelphia | $49,919,180 | $9,918,311.65 | $956,910.14 |
| San Francisco | 58,258,000 | 5,604,275.00 | |
| New Orleans | ......... | 12,199,000.00 | |
| Total | $108,177,180 | $27,721,586.65 | $956,910.14 |

Refined bars were produced at all the mints and assay offices, however, as follows:

| Institutions. | Deposits of metal. | Refined bars manufactured. | |
|---|---|---|---|
| | | Gold. | Silver. |
| Philadelphia | $84,936,261.38 | $868,012.48 | $117,478.08 |
| San Francisco | 61,315,442.48 | .......... | 17,188.28 |
| New Orleans | 13,447,938.39 | 3,870.75 | 3,950.85 |
| Carson | 306,976.30 | .......... | 9,342.24 |
| Denver | 21,180,138.28 | 21,114,763.13 | 62,872.07 |
| New York | 62,336,445.67 | 53,170,116.54 | 8,195,351.06 |
| Boise | 1,564,698.73 | 1,280,657.17 | 25,141.67 |
| Helena | 2,077,991.34 | 2,036,679.26 | 39,061.26 |
| Charlotte | 244,737.45 | 243,431.68 | 1,305.77 |
| St. Louis | 111,779.35 | 110,827.83 | 951.52 |
| Deadwood | 319,748.69 | 317,301.58 | 2,447.11 |
| Seattle | 6,550,698.16 | 6,395,250.11 | 111,660.72 |
| Total | $254,392,856.22 | $85,540,910.53 | $8,586,710.63 |

A laboratory is maintained at the mint for making tests of weight and fineness. This work is continuous. A special committee is appointed as a further safeguard. Coins are standard at .900; .003 is the limit of tolerance. In no case was a newly coined piece found to be outside the limit in 1899, while only one was discovered in 1898. But few coins depart more than .001 from the standard. These figures show the exactness with which the unit for judgment of value is preserved in the standard money of the United States, while the redeemable coins are watched quite as closely.

*Work of the mint.*

When a reserve of gold is not kept, equal in amount to the credit money outstanding, a revenue department of the Treasury is essential. The present reserve fund serves only to give confidence in the ability of the Government to meet present demands. For the time being, $150,000,000 of gold in the National Treasury is deemed a sufficient guarantee that the Government will be able to meet its money obligations. But it is quite as necessary to give assurance of ultimate ability to meet all outside obligations. Under ordinary conditions a few millions of dollars in gold will suffice to keep the whole $1,369,000,000 of credit money valued at par. There are times, however, when for business reasons, those holding this credit money may wish to have a large portion of it redeemed in gold. Demands for gold for private use, demands for export, or some shock to public confidence in the credit system may cause an extraordinary strain on the Treasury. The possibility of such unusual demands dictates that some means of maintaining the reserve intact should be provided. In 1893 the Government found itself in a position where the reserve was not only impaired, but its very existence threatened. The result was the impairment of all the credit relations of the nation. All private as well as public credit depends on confidence that the Government will be able to redeem its promises, and

*Relation of the Revenue Department to.*

pay gold in exchange for credit money outstanding. It is this that links the monetary promises of the Government to its fiscal transactions—that makes necessary a revenue power as part of its credit money system.

*Possible demands on the Treasury for gold.*

The Report of 1901 shows that on June 29, 1901, the Government had in hand $385,642,560.46 of gold coin, and $109,205,736.96 worth of gold bullion—$494,-848,297.42 in all. As against this, the Government held a special 5 per cent National Bank-note reserve fund of $13,267,236.27, a special fund of $289,017,689 for the redemption of gold certificates, and various other special deposit and redemption accounts outstanding to the amount of $8,545,644.24. Add to these amounts the $150,000,000 reserved by law for the redemption of the credit money of the United States, and we have a total special reserve of $460,830,569.51 which must be subtracted from the gold in the Treasury to determine available funds. This leaves a net balance over and above the redemption funds mentioned of only $34,017,727.91, which at that time might have been devoted to the maintenance of the Government and to meeting its fiscal obligations.

The receipts for the year from various sources were $3,011,031,891; the disbursements, $2,993,795,160. The moneys received and disbursed were as follows:

| KIND OF MONEY. | Received. | Disbursed. |
|---|---|---|
| Gold coin | $178,219,548 | $166,484,087 |
| Silver dollars | 59,898,211 | 49,741,106 |
| Fractional silver | 42,966,427 | 41,225,029 |
| United States notes | 490,060,280 | 506,035,348 |
| Treasury notes | 52,918,520 | 53,361,616 |
| National bank-notes | 195,676,393 | 196,670,339 |
| Gold certificates | 1,268,944,399 | 1,256,329,229 |
| Silver certificates | 717,587,461 | 719,497,448 |
| Minor coins | 4,760,652 | 4,450,958 |
| Total | $3,011,031,891 | $2,993,795,160 |

*Sources of revenue to meet gold demands.*

From all sources, including redemptions, clearing-house balance and transfers, and expense of Government, during the year 1901, $11,735,461 more of gold was received than was disbursed. As before shown, the actual demand for redemption was only about $\frac{1}{3}$ of one per cent, while the net demand for gold for this purpose was only about $\frac{5}{1000}$ of one per cent. Suppose, however, that under our system of interchangeable credit money the net demand for gold had risen to 5 per cent—a very usual demand in times of business adversity and financial strain: this would have made a difference of over $140,000,000 in the amount of gold in the Treasury. Not only would the surplus be wiped out, but two-thirds of the gold reserve also. To meet such an emergency the Government must rely on its revenue powers. Of these it has three: (1) Taxation, (2) sale of available assets, and (3) sale of its bonds. That it may not always rely on taxation is evident from the nature of the money in which taxes are payable. For example, in the year 1901, $622,606,298 of gold were received through customs and customs deposits. Yet, with these receipts, only $11,735,461 more of gold was received than disbursed. When the demand for gold is strong the gold receipts from customs and taxes become small. Through its taxing power, the Government is unable to secure gold with which to protect its reserve. When the taxing power is inadequate, disbursements in payment of officers, etc., may be made in forms of credit money, but this can not do more than temporarily protect the Treasury. The credit money disbursed soon finds its way through the redemption agency. The excess of credit money paid out during times of strain sets in motion the "endless chain" of redemptions that draws away the surplus. A decrease in the expenses of government may somewhat lessen the demand, but if the demand for gold through outstanding credit currency be strong, the reserve may fall to a low point, and in such an

*1. Taxation inadequate.*

event neither present economy nor power to obtain future revenue through taxation can avail to maintain it.

In the Treasury at the time mentioned there were $453,702,931 silver dollars, $10,587,556.93 in fractional silver, and $49,396,841.98 silver bullion—$513,687,329.91 of silver coin and bullion as an asset. Had this been sold for gold, and relief found by conversion of quick assets, the silver owned would have produced something like $250,000,000 in gold coin, and would have reduced the credit liabilities of the Government to the same extent. But the Treasurer had no legal power to dispose of the silver in his possession. He might have turned to his bank assets, of which at the time he had $100,010,493.95 on deposit in the National Banks. This might have been turned into cash, but it would have given no relief, for the banks would then have converted the United States notes and the other credit money reserves held by them into gold by presenting them at the redemption agency. The gold reserves of the Government would have been reduced in like amount.

*2. Sales of assets of Government.*

The third revenue power, loans, must now be resorted to. From this alone can relief come when the other powers fail to meet monetary credit demands. Without this power our whole credit currency system would have failed in 1893. In time of stress, with $1,369,000,000 of credit money outstanding against the $150,000,000 reserve, the loan power may be as essential to the maintenance of the United States Treasury as is the power to contract loans necessary to the maintenance of the credit accounts of a commercial bank.

The service performed by the United States Treasury is at once apparent. Upon it depends the integrity of our whole money system, and out of the integrity of the money system grows our system of private credit. From the United States Treasury we now turn to the private institutions and agents used in funding operations.

*Service of the Government.*

## CHAPTER X

### THE SAVINGS-BANK

UNDER a system of exchange, based on consent of parties, any kind of business may be profitable to the extent, and only to the extent, that it renders a service to society. One who can not offer to others something which will give them greater enjoyment or greater business advantage than can be had elsewhere at the same price, must either keep the thing offered or reduce the price until, in the judgment of some member of the community, an advantage is to be found in exchange. But one can not sell at a price which will yield him no profit and remain long in business. A business man must get a return which will pay him for his effort, as well as offer some advantage to others who deal with him. The formula of successful business is: *Price* must equal *cost*, plus a *profit*. Again, one who offers to sell goods at a price which will yield him a profit must compete with all others in the market. The fact that there are buyers is proof that, in the judgment of those buying, a service is rendered to them by the one offering goods; the fact that the one who offers goods at a price which brings customers—i. e., remains in a business —is proof that he produces and sells at a price which yields a profit. In other words, the business man is able to continue the particular business in which he is engaged under these circumstances only: that he can both serve the community and at the same time serve himself.

*Every business based on service rendered.*

His profit can not be greater than the total service rendered, for when he offers goods at a price which leaves no advantage to buyers, they will refuse to deal with him. The amount of his profit on a particular sale will be the difference between the *cost* of the thing sold and the *price* obtained—his profit is the margin of advantage which he is able to retain for himself through the organization, equipment, and management of his business. Let us take for illustration a primitive agricultural community, such as may be found in many parts of Europe. In such a community a man with a hoe is able to obtain an income from his occupation sufficient to allow him to eke out a miserable existence. This is made possible because the European farmer has his business so organized that, at the price paid (a life pittance), "the man with the hoe" is a more profitable laborer than any other at his command—the European farmer therefore employs him. In the Mississippi Valley, on the other hand, the man with the hoe is useless at any price; here the business of agriculture is so organized that a high-class machinist (a man of high-grade intelligence) is the more profitable. "The man with the hoe" leaves Italy and goes to Ohio. In doing so, however, he finds his old occupation gone; he must either change his implements of toil or he will soon find himself in the almshouse. In parts of France and Spain, in fact through a large portion of Europe, the machine-laborer of the American farm would be quite as helpless. There, to find employment on a farm, he must forsake his old method of labor and become a man with a hoe. To follow the sentiment of Mr. Markham in his remarkable poem, "the man with the hoe" is doomed; while he is tilling a garden spot (a few acres at most), the Western farm-hand is "tending" 30 or 40 acres of oat-land and seeding as many acres of wheat, 30 to 50 acres of corn, and has in crop rotation 40 to 60 acres of meadow-land and 60 to 80 acres of pasture. He has in productive use from 200 to 300 acres of fertile land. The peasant has for

his labor a few tons of produce, all told. The American, with his horses, engines, machines, and tools, is producing from 2,000 to 3,000 bushels of corn, from 1,200 to 1,600 bushels of oats, from 800 to 1,400 bushels of wheat (i. e., 4,000 to 6,000 bushels of cereals), and from 60 to 80 tons of hay; he also is keeping from 50 to 80 cattle and from 50 to 100 swine. The peasant produces little more than enough for his own keep; the Western farm-laborer reaps a harvest of foodstuffs large enough to feed a whole regiment of laborers who are working in other fields. The American farmer has a large surplus of food to exchange for things produced by others, while other producers, being free to devote their time to their occupations, are as liberally provided with a surplus of useful products. In the competition between Europe and America in the markets of the world, the equipment of the Western farmer is so far superior to the equipment of the farmer of the Old World that even the small pittance must be denied to the peasant-laborer, while the American "farm-hand" may demand good wages and still leave a wide margin of profit to his employer. An iron-founder builds up a large and profitable business in a community where before only a blacksmith shop was found. How, it may be asked, is this made possible? There can be but one answer: the founder is able to shape his materials better or more cheaply than his competitors. To do this he must so organize, equip, and manage his plant that he can offer better services to the community than did the blacksmith.

*Increased profits the result of increased capital.*

Profits are made by obtaining funds with which to equip some business based on service to be rendered. Some business advantage is recognized; some service may be rendered for which others will pay; to perform this service a new form of equipment is needed. In obtaining funds for this purpose, however, the one who undertakes it must so organize his service, furnish himself with such mechanical appliances,

and direct his business in a manner to put him on a footing superior to competitors. There must be a better adaptation of means to end. The means at hand are not entirely material and mechanical. He needs the assistance and skill of his fellows; his scheme of success must be one which will allow him to call in the services of others; for this he needs funds. Even the things necessary to his mechanical equipment can not be obtained to advantage except by exchange with those whose business it is to furnish them; this requires funds. In other words, one must have capital to work to advantage, or to do business at a profit. The larger the capital the more highly developed the industrial organization, the greater are the opportunities made possible to him possessed of the intelligence to avail himself of them.

*Saving as a means of obtaining capital.*

In recognition of this advantage men direct their energies toward obtaining more capital. It has been before observed that the only way that a laboring man has of obtaining capital is by a process known as *saving*. For the purpose of his own income the laboring man is a business concern. He is governed by the same rules of success or failure as a business corporation. Let us take, for example, the New England Telephone and Telegraph Company. It has equipped itself for serving those who have messages to be sent from place to place. In order to do this more effectively, it has provided itself with wires, poles, buildings, instruments, etc. The earnings of the company received during the year 1899 for services performed were as follows:

| | |
|---|---|
| Exchange service (telephone) | $2,934,075.59 |
| Toll service | 818,459.73 |
| Private line service | 68,225.36 |
| Messenger service | 51,778.14 |
| For rents (real estate) | 1,802.92 |
| Interest on stocks and bonds of other companies owned | 50,402.50 |
| Miscellaneous | 21,610.39 |
| Gross earnings for year | $3,946,354.63 |

The expenses incurred in performing this service were as follows:

| | |
|---|---|
| General expense, including taxes | $640,107.95 |
| Operating expense | 652,075.64 |
| Maintaining the plant | 1,384,258.82 |
| Rentals and royalties | 220,724.28 |
| Private line expense | 12,399.54 |
| Messenger expense | 50,693.51 |
| Real estate expense | 1,028.90 |
| Total expense of year | $2,961,289.34 |
| Net earnings for year | 985,065.29 |

*Earnings.* The carpenter finds it necessary to equip himself with the tools of his trade. His earnings for the year are:

| | |
|---|---|
| Work on Jacob Reiss's barn | $184.00 |
| Work on the Emerson house | 265.00 |
| Shingling Patterson store | 67.00 |
| Repairs on First Nat'l Bank bldg | 138.50 |
| Shop work during year | 214.25 |
| Total earnings for year | $868.75 |

As a means of carrying on this service, however, the carpenter must pay out a certain amount in expenses. He *Expenses.* has clothes to buy to protect himself from wind and weather and to make himself presentable in society; he has a poll-tax to pay; he needs shelter, etc. His working plant must be maintained—i. e., he must provide himself with food and repair tools broken or worn out. At the end of the year his expense account closes with the following summary:

| | |
|---|---|
| Clothing | $89.00 |
| Taxes | 2.00 |
| Board | 268.00 |
| Repairs of tools, etc | 27.75 |
| Room rent | 96.00 |
| Shop rent | 100.00 |
| Incidentals | 53.00 |
| | $635.75 |
| Net earnings for the year | 233.00 |

The net result of service in the New England Telephone and Telegraph Company was $985,065.29. But this company had an equipment that represented a capital of $19,000,000. The carpenter's net earnings were $233; his equipment cost him only $500. During the year an outhouse burned, where he was working, and he had a set of planes and some other tools destroyed. It will cost him $50 to replace the loss. This must be made good to place him in the same position he was in at the beginning of the year. The $233—the net result of his services—are not, therefore, clear profit. His profit and loss account will appear as follows:

*Profits.*

PROFIT AND LOSS.

| | | | |
|---|---|---|---|
| Loss by fire............ | $50.00 | Net earnings.......... | $233.00 |
| Net profit for year...... | 183.00 | | |
| | $233.00 | | |

The question now arises, What will he do with the $183 profits on the year's business? One of his expenses incurred was $100 for the rent of shop. He had paid out this amount for the use of a building as a means of providing better equipment than he could have furnished with his own capital. He also recognizes that he could work to higher advantage if he had a steam-engine and some lathes. None of these things will be of use, however, till he can get all of them together. He decides to lay by the $183 and add to the amount the profit of each year till he has $1,000—the sum that it will cost to buy his machines. It is this process of *laying by the surplus earnings* or *net profits* for capital use that is called saving.

*Savings from labor.*

The service rendered by the savings-bank finds illustra-

tion in a story told of a journeyman blacksmith. He was a man of more than ordinary ability, but addicted to drink. His employer, becoming interested in the man, thought that he might induce him to reform his habits. He pointed out to the journeyman that he was a man of talent; that he could get regular employment and good wages; that he was spending his income in a way that would add nothing to his comfort; not only was he not improving his mental condition, but he was contracting a habit which would finally render him morally irresponsible and physically unsound. Continued indulgence of appetite would so far unfit him for service that no one would care to employ him in his present capacity. He would ultimately be reduced to the ranks of the incompetent and end his days in poverty. All this the dissipated journeyman admitted frankly. "But," said he, "what is there for me to live for and work for except the present? What encouragement have I to try to get on in the world? At one time I entertained some hope for better things, but this hope is gone." He recounted that after learning his trade he had started out with the best of resolves. When young and strong he had determined to devote himself industriously to his trade, to work as a journeyman until he had laid up enough to buy a shop of his own. He hoped ultimately to become an employer of men, to profit from the skill and labor of others, instead of having to sell his own labor to those who had the capital with which to make the most of it. By industry and thrift he had the first year saved $200. This he deposited in a commercial bank. The second year added $250 more to his account. A few months later, however, after he had saved something over $500, the bank failed, and an insolvency proceeding of two years left him about $100 in dividends from the bankrupt estate. He resolved to trust banks no further. The only service which they could render him was to provide a place for the safe-keeping of his savings. They had

*The service of the savings-bank.*

failed in this. The banks had everything to gain from his patronage; he had everything to lose from failure. He now purchased a wallet and in this decided to carry his savings until he had accumulated the requisite amount. Coin was heavy; he exchanged all money of this kind received for paper money, and small bills were traded for large ones; these he could easily tuck away in his wallet. The wallet he kept with him while at his work, and for safety guarded his sleeping-room with a strong bolt. He finally got together about $600. Again he thought the time at hand when he might become the proprietor of a shop. One night, while asleep, a fire broke out in the house where he lived; the smoke thickened around him; he became stupefied. Neighbors coming to the rescue forced the bolts and carried him out in time to save his life, but his wallet was left behind. Nearly six years of industry and sacrifice had come to naught. In despair, he determined to enjoy his earnings as fast as he received them.

Here was a man of skill; a man of industrious habits; a man who needed only the encouragement of protection to rise to a high plane of industrial efficiency. But the conditions were unfavorable to his rise. During the last part of the eighteenth century and the first part of the nineteenth the laborer's lot was a hard one. In Europe, wages were still low, and a quarter of a century of almost continuous warfare (the wars of Napoleon) made foodstuffs high. There was small opportunity for the man who had no means of using his own labor and no means of support other than the sale of his skill. England, the most prosperous among nations, was overrun with paupers. American conditions were somewhat more favorable to the laborer, on account of the opportunity offered to get out on new lands and to possess himself of resources from which he might earn a living, regardless of employment and employers; but even here there was little care for the wage-earner as such, the man without capital.

*Conditions giving rise to the savings-bank.*

The first savings-banks were started as benevolent institutions, purely and simply. Prof. Albert S. Bolles summarizes the history of their rise in the following admirable manner: "When a great want is felt in the world men begin to try to solve the problem of how to satisfy the want. This question of dealing with simple men and women, of taking care of the humble who had no assets, or taking care of the poor who come to want by improvidence or by misfortune, appears to have received the studious notice of the economist and the philanthropist at the same time. When Jeremy Bentham and Malthus enforced the benefits of saving in the interest of the great body of the people, as well as those who saved, about the opening of the century, an English clergyman and a Scotch minister, each in his own parish, set in operation a plan for his parishioners to save money which embodied in substance the fundamental principle of the savings institution. Contemporaneously, a woman, Mrs. Priscilla Wakefield, established such an organization in England. Similar ideas were also advanced at the same time by a London magistrate, Patrick Colquhoun, who wrote upon the question of popular indigence and measures for its relief as early as 1806. In America, in 1816 and 1817, the needs and the claims of the poor awakened attention at Boston and New York, and thought was immediately directed toward a savings institution, because it was deemed most helpful. In Boston, in 1816, it was proposed 'to form an institution for the security and improvement of the savings of persons in humble life until required by their wants and desires.' The first savings-bank in the State of New York was the direct result of a meeting of citizens at the New York Hospital on December 16, 1817, to take into consideration the subject of pauperism. A committee was appointed to report on the prevailing cause of poverty. The report recites, among other causes, that 'prodigality is comparative among the poor; it prevails to a great extent from

*The first savings-banks.*

inattention to those small but frequent savings when labor is plentiful, which may go to meet privation in unfavorable seasons. When the constitution of this society was drafted, it declared that one prime purpose of the organization should be 'to hold out inducements to those people to economy and savings from the fruits of their own industry in seasons of great abundance.' The earnestness of the men who were members of this organization is proved in the passage of the act upon their petition, by the Legislature in 1819, for the incorporation of a bank for savings. In each of the two years thereafter a savings-bank was incorporated in that State. The Philadelphia Savings-Bank was incorporated in February, 1819."

The service to be rendered by the savings-bank is quite a different one from that rendered by the commercial bank. With the wage-earner the principal financial service to be rendered is not one of providing current funds to him who already has capital; it is one of providing a safe investment for the small savings, or surplus net earnings, of the wage-earner in the form of an interest-bearing credit account of men without capital, men who are toiling for others in order that they may accumulate capital funds. The first prerequisite of a savings account is safety; the second is a return of income on the investment compatible with safety. A man with a shilling or a pound, a dollar or even twenty dollars, can seldom find opportunity to invest such a sum to advantage. But when the shillings and pounds and dollars saved by the many are exchanged for interest-bearing accounts, the fund brought together in the bank each week or month will be large enough to enable its officers to invest them safely at a still higher rate. This furnishes a source of income, and immediately converts the small savings of the laborer into an investment capital. The laborer need not wait until he gets a large fund together before he can use it. Moreover, he does not

*The safe investment of savings.*

*The investment of savings-banks.*

feel that his saving is a sacrifice, but that he is rendering to himself a service and providing himself with the means to higher enjoyment. With *safety* and *earning power* combined, the inducement to saving is vastly increased—the industrial community becomes more highly capitalized, more efficient, more highly cooperative, and farther removed from want. The motive to extraordinary efforts and saving is shifted from that of self-sacrifice to one of higher enjoyment. The laborer is encouraged to strive to acquire a working capital which will give him either higher industrial efficiency or an investment fund, the income from which will yield a larger competence.

The service which it is possible for such an institution to render in an ordinary community may be illustrated from the industrial organization of a typical town. In the place referred to is a flouring mill, a foundry and machine shop, two implement factories, a brewery, and a wagon factory. These establishments employ about 500 men; besides these, there are railway shops which give employment to some 250 more. Some of these receive large salaries, others are common laborers. The 750 employees receive, on the average, about $2 per day. Altogether they earn about $1,500 daily—over $35,000 per month. Out of this income they have to pay living expenses. With each, however, there is a possibility of saving something. Some of the better paid ones may save as much as $25 per month; others may not lay by more than $2 or $3 per month. Let us suppose that on the average $5 per month might be saved. This would give a gross saving fund of $3,750 per month for deposit in savings accounts. But there are also between 500 and 600 domestic servants in the town that earn on the average $3 per week—about $6,500 per month, besides board and lodging. Let us say that $2,500 of this amount could be made available for investment. This would increase the monthly income of a bank to $5,000.

*Illustration of the service of a savings-bank.*

While $1 or $5 could not be conveniently kept or otherwise judiciously invested by the laborer, the bank, with $5,000 in hand at the end of each thirty days, could do either. Sixty thousand dollars each year for five years only would give an institution $300,000 for investment. If each laborer contributed but a mite, the possibilities of such an enterprise through the long course of years would prove attractive to the best financial managers, and the services of such would prove highly beneficial, not only to the individual depositors but to the whole industrial community. In a large city, contributions of nickels and dimes from the many, in time produce an enormous fund. The Philadelphia Savings Funds Society to-day has accounts which amount to over $60,000,000, and this fund has been built up largely by the savings of the servant class.

The commercial bank must of necessity keep a large percentage of its capital funds available for meeting its demand credits. It is organized to serve a commercial constituency by providing current funds in this form. As a means of maintaining its demand credit, capital contributions of money are essential. The savings-bank needs no capital stock. A savings account is not a current fund. Savings depositors do not ordinarily withdraw their accounts except in emergencies, or for some better ultimate use to which the savings may be applied. The demands for withdrawal, therefore, are ordinarily smaller than new investments of savers. Provision is usually made for withdrawals in excess of income, but a reserve of money is not at all essential to maintaining the credit of the institution if proper steps are taken for its protection. The People's Savings-Bank of Pittsburg, for example, at the time of making its report to the State Commissioner of Banking, November 19, 1900, had accounts to the amount of $6,913,472.84, while it had on hand only $4,776 in cash and cash items. The Dollar Savings-Bank of the same place and on the same date had

*Savings are capital funds.*

$19,844,617.71 in accounts, and only $37,432 in cash and cash items. There are in the United States about 1,000 savings institutions, of which 700 are "mutual"—that is, they are institutions operated by trustees for the exclusive benefit of savers. They are not organized to make money for the corporation, but to provide safe investments in the form of interest-bearing accounts. The officers and employees receive stipulated salaries for services rendered, and no dividends are paid except to those who have funds on deposit. Nearly all of the early institutions are of this kind.

The first function of the savings-bank—that of safe investment of small funds—may not be performed by building vaults and storing away the money as it comes in, and then paying it out again when requested. The bank not only could not pay interest on accounts, but would suffer a net loss. This is incompatible with the prime object of the savings institution. It is only when safety is associated with income-producing power that the funds may be preserved safely and undiminished. The second function—that of paying an income on savings accounts—may be performed only by allowing the managers of the bank to use its funds in a way to produce revenue for the institution with which to pay expenses, repay the amount of the accounts, and add thereto an increment of interest or dividends. The success of an institution depends upon keeping its funds invested. This may be done only by establishing credit relations with the depositor on the one hand and with borrowers on the other. The credit relation with the depositor is established in the following manner: The laborer receives his weekly wage and is able to lay by out of the amount received, we will say, $1 after paying expenses of living. In case he is employed during business hours, his wife may take this dollar to the savings-bank. On entering the bank she may meet a janitor or usher, who, learning her purpose, will show her a small wall-desk upon

*How to deal with a savings-bank.*

which are pen and ink and proper blanks to be filled out. By following his directions, or those which she may find printed before her, the "deposit ticket" will be filled out, giving name, address, date, and amount to be deposited. (Many of the banks make out the deposit tickets themselves on account of the difficulties experienced in reading the entries of depositors. But the self-executed ticket is considered preferable by others on account of the evidence of the amount deposited being in the handwriting of the depositor, if dispute arises. This is oftentimes of advantage in allaying suspicion of dishonesty on the part of an institution dealing with ignorant people.) The ticket with the money is passed in at the window labeled "Receiving Teller." The depositor is now asked to step to the signature-book and write her name, and give such information as to residence, age, color of eyes, occupation, domestic relations, etc., as may be considered necessary to identification. On the signature-book a number is placed opposite the name by which the account thereafter is to be known in all transactions of the bank. The "Receiving Teller" then makes out a "Pass-book" on which this number is stamped, enters the amount deposited, and hands it to the depositor. Thereafter all moneys deposited are entered in similar manner. Now, what has the woman in exchange for her dollar? The bank has one dollar more of money than it had before. In making the exchange, the woman has bought a credit obligation of the bank to pay her one dollar. To be paid when? Not on demand, as in the case of deposit in the commercial bank, but after the prescribed notice (perhaps ten days) to be given to the bank of the intention of the depositor to withdraw. This rule is made in order that after notice is given the bank may not invest the money paid in by depositors until sufficient has been held back to pay withdrawals for which notice has been given. After sufficient coin has been retained for this purpose, however, and for current expenses, the bank has no need for

holding a reserve, and the other money deposited is free for investment.

But what kind of investment shall the bank make? Will it buy commercial paper, as does the commercial bank?

*Rules governing investments of the savings-bank.*

It would not be to its advantage to do this. The "deposits" sold are not for current use; they are bought by the depositor as an investment—a long-time investment. Nor can they be used as current funds on account of the notice necessary for withdrawal, unless the bank elects to have it so. Since the deposits are not to be used as currency with which to produce or to buy goods, and since the purchase of commercial paper would not create new deposits at the savings-bank, it would only involve itself in risk and trouble by so doing. The managers of the savings-bank do not come into immediate business contact with merchants and manufacturers, and have little opportunity to know of the condition of their affairs. But even if it could keep in touch with them, such transactions would be one-sided, and the investments in commercial paper would have to be renewed every thirty, sixty, or ninety days as the case might be. There are many reasons which argue against such a disposition of funds; there is little in its favor.

*Safety of investment.*

Of all things that the savings-investment manager must take into account, the element of safety is of most importance. The bank wants none but safe investments. It also wants long-time instead of short-time investments. An investment that combines these two qualities, however, is usually one of comparatively low rate of income. The amount of investment capital seeking that kind of employment is larger in proportion to the amount of "gilt-edge" investments on the market than the amount of capital seeking investments in which there is a higher element of risk—therefore the lower rate of interest. The character of investments made by the conservative savings-

*Rate of income.*

bank is best shown by published reports of these institutions themselves. For the Philadelphia Savings-Fund Society the general classification of its investments is as follows

| | | |
|---|---|---|
| Deposits with other banks and bankers | | $1,028,274.98 |
| Call loans upon collaterals | | 3,800.00 |
| Time loans upon collaterals | | 3,500.00 |
| Investment securities owned: | | |
| Stocks and bonds | $45,505,169.75 | |
| Mortgages | 13,319,592.38 | |
| Total investment securities owned | | 58,824,762.13 |
| Total | | $59,860,337.11 |

This accounts for its entire assets, except cash on hand, real estate, furniture, and fixtures. A smaller concern, the Nation's Bank of Savings of Allegheny, may be used for illustration. Its investments appear as follows:

| | | |
|---|---|---|
| Deposits with other banks and bankers | | $105,333.84 |
| Call loans upon collateral | | 264,025.00 |
| Time loans upon collaterals | | 45,625.05 |
| Investment securities owned, viz.: | | |
| Stocks and bonds | $33,350.00 | |
| Mortgages | 510,966.28 | |
| Total investment securities owned | | 544,316.28 |
| Total | | $959,300.17 |

*The mutual and the joint-stock savings-bank.*

The first institution is an old-line "mutual" company. The second is a "joint-stock" company with a capital stock of $100,000. The first is operated by trustees for the benefit of depositors. The second is operated by managers who offer a certain percentage on deposits, as a fixed charge on the gross earnings of the corporation, the profits going to the stockholders in the form of dividends. The policies of the two banks with reference to investments is evidently quite different. The Philadelphia Savings-Fund Society has about 92 per cent of its funds invested in bonds and mort-

gages—75 per cent being in the form of first-class bonds. The bond investments appear as follows:

| | | |
|---|---|---|
| United States loans, reg. 4 per cent........ | $1,967,187.50 | |
| Dist. Columbia, guaranteed by United States 3.65 per cent.......................... | 1,000,000.00 | |
| Total United States bonds ............ | | $2,967,187.50 |
| Pennsylvania State, reg. $3\frac{1}{2}$ and 4 per cent . | $860,000.00 | |
| Philadelphia City, reg. $3\frac{1}{2}$, 4, and 6 " . | 3,635,275.00 | |
| Chester City, reg. 4 per cent............... | 40,000.00 | |
| Allegheny City, reg. 4 per cent ............ | 606,000.00 | |
| Pittsburg City, reg. 4, 5, 6, and 7 per cent.. | 1,544,900.00 | |
| Reading City, reg. 4 per cent.............. | 60,000.00 | |
| Baltimore, Md., reg. and comp. 4, 5, and 6 per ct. | 330,000.00 | |
| Boston, Mass., reg. and comp. 4 and 5 per cent | 56,878.60 | |
| Wilmington, Del., reg. 4, $4\frac{1}{2}$, and 6 per cent. | 34,500.00 | |
| Louisville, Ky., comp. 4 and 7 per cent..... | 170,000.00 | |
| Zanesville, Ohio, comp. $4\frac{1}{2}$ per cent ........ | 70,000.00 | |
| Cincinnati, Ohio, comp. 7 and $7\frac{3}{10}$ per cent.. | 55,000.00 | |
| Cleveland, Ohio, 4 and 5 per cent.......... | 203,000.00 | |
| St. Paul, Minn., comp. $4\frac{1}{2}$, 6, and 7 per cent | 212,000.00 | |
| St. Louis, Mo., comp. 4 per cent ........... | 101,000.00 | |
| Toledo, Ohio, comp. $4\frac{1}{2}$ per cent ........... | 115,775.00 | |
| Woodbury, N. J., comp. 4 per cent......... | 62,000.00 | |
| New York City, reg. $3\frac{3}{4}$ per cent........... | 800,000.00 | |
| Total city and State bonds............ | | $8,095,328.60 |
| Bonds of counties and boroughs, 4 to 6 per cent.......... | | 549,000.00 |
| Total municipal and Government bonds ................ | | $11,923,615.10 |
| First-class railway bonds.............................. | | 33,581,554.65 |
| Total........................................ | | $45,505,169.75 |

Of the railway bonds, about one-fourth were held against the Pennsylvania Railroad, financially one of the strongest corporations in existence, and another one-fourth were held against the New York Central, the Erie, the Lehigh, and the Northern Pennsylvania Railroads. No shares of stock whatever were held. Nearly all of the bonds are what are known in the market as "gilt edge."

The Nation's Bank of Savings had only about 3 per cent of its funds invested in bonds, and these were entirely local and industrial. It had 50 per cent of its assets invested

in mortgages. It is to be presumed that these were also largely local and industrial. Fifty-four per cent as against 92 per cent in bonds and mortgages, and those of an inferior type in the general security market! About 10 per cent of its funds were "on deposit" in other banks, while 30 per cent were invested in commercial paper—short-time loans secured by collateral. The loans of this character made by the Philadelphia institution amounted to about one-tenth of 1 per cent. Whether this difference grows out of the joint-stock interest of its managers will not be said, but certain it is that the Allegheny concern is quite as closely allied with the commercial interests as it is with the interests of the working man.

*Comparison of methods.*

The deposits that go to the savings-bank are usually in the form of minor coins, silver, and what is generally considered "change." The collection of such money gives the bank a double importance in its relation to the money system of the country. It reduces the amount of small change that the Government would otherwise be called on to furnish to the people. By providing a method for the safekeeping of funds, (1) it reduces the amount of money that would go into hoards, and thereby reduces the demand on the Government; (2) it indirectly sets up a chain of redemption through the Treasury. The savings-bank also has an important relation with the fiscal side of the Treasury. When an issue of bonds is offered for sale, these institutions are among the largest purchasers. They therefore facilitate the funding process of the Government. In 1899 the savings-banks had investments amounting to \$137,000,000 in United States bonds. The total deposits of that year were \$2,179,468,299. Their income amounted to over \$5,000,000 per month, while cash on hand averaged about \$100,000,000. These banks are therefore, under ordinary circumstances, in a position to absorb a large issue of public securities.

*Relations of savings-bank to the money system.*

The business relations of the savings institution to the commercial bank are largely represented by its "deposits" in those banks. There are times when withdrawals exceed deposits; in periods of panic—times when those having securities and other properties must realize on them *at once* in order to meet present credit obligations, when sales of securities are made at a sacrifice—many depositors of savings may find it to their interest to exchange their savings investments for the properties offered for sale; in times of depression also, when the laboring constituency of the savings institution is out of employment, large withdrawals may be necessary to meet living expenses. If, upon such occasions, the savings institutions do not have a part of their investments in such form that they may be readily converted without loss, they may become embarrassed. Their constituency may become frightened and begin a "run." Such occasions of emergency and adversity suggest to the savings manager the desirability of keeping a considerable part of the institution's funds "deposited" in one or more commercial banks at a low rate of interest. The percentage of funds "deposited" will vary with the circumstances of each institution. The commercial banks are always ready and willing to sell credit accounts—that is, to buy cash from the savings-banks with their own demand credit, and pay from $1\frac{1}{2}$ to $2\frac{1}{2}$ per cent for the time that payment is deferred. It is of advantage to the commercial bank to receive deposits from the savings-bank, because the money thus deposited strengthens its reserve, and enables it to exchange a larger amount of bank credit for loans. The low rate of interest paid by the commercial bank to savings institutions on deposits, however, makes it quite imperative that the savings-bank keep only such amount invested in this way as business safety requires. It sometimes happens that those who manage savings institutions have a personal interest in keeping deposits in other institutions.

*Relation of savings-bank to other financial institutions.*

When this is the case they are wholly unfitted to remain in fiduciary relations to depositors. In some States, statutes have been passed regulating the qualifications of officers in savings institutions. Past experience has suggested the propriety of such laws.

# CHAPTER XI

## THE BUILDING LOAN ASSOCIATION

Little more than a quarter of a century had passed before the principle of saving was applied in a different way. The savings-bank gave to the wage-earner an opportunity safely to *invest* his surplus dimes and dollars until he wished to use his capital for industrial purposes or until he could employ them to greater advantage in an independent way. This gave the best of encouragement to saving and to the accumulation of funds for capital use. The Building Loan Association was an *investing institution* which advanced to the wage-earner funds for his immediate use on the security of his future savings. It has been noted that the savings-bank sells interest-bearing book-accounts to customers and then invests the funds deposited in "gilt-edge" securities of other concerns which bear a slightly higher rate of interest than the rate paid to depositors. The Building Loan Association receives a definite amount of money each month as a payment on stock held by members of the association; the company then invests the amounts received in loans to its members—the members having the profits from the loans applied to the balance due on stock. For example, an association is formed with a thousand members; each member takes one share, the par value of which is $100; he pays down $1, and agrees to pay $1 per month on the stock till, with the accumulated profits, the stock is paid for. This gives to the association an income from stock payments of $1,000 per month, which may be loaned

to its members on such terms as may be provided under its rules.

The distinguishing characteristics of the Building Loan Association are the following: (1) Usually every borrower from the association is a stockholder—that is, the company can not invest in any credit obligations or securities other than those of its members; it is a close corporation both as to membership and as to dealing. (2) The capital of the corporation is not represented by the amount of stock outstanding, but by the amount of the combined savings, interest, and premiums paid in by its members after deducting expenses. To put it in the language of the Ninth Annual Report of the Department of Labor: "The stockholder or member pays a stipulated minimum sum, say one dollar, when he takes his membership and buys a share of stock. He then continues to pay a like sum each month until the aggregate of sums paid, augmented by the profits, amounts to the maturing value of the stock, usually $200, and at this time the stockholder is entitled to the full maturing value of the share and surrenders the same. It is seen clearly, then, that the capital of a building loan association consists of the continued savings of its members, paid to the association upon shares of stock, increased by the interest and premiums which the association has received from loans made by it from the savings of its members thus paid to the association, and from all other sources of income. The amount of the capital of the association, therefore, increases from month to month and from year to year. Shares are usually issued in series. When a second series is issued, the issues of stock of a prior series cease. Profits are distributed and losses apportioned before a new series issue. The term during which a series is open for subscription differs, but it usually extends over three or six months, and sometimes a year. Prior to the maturing of a share it has two values: one is called the holding (or book value), and

*The distinguishing features of the Building Loan Association.*

the other is called the withdrawal value. The former is ascertained by adding all the dues that have been paid to the profits that have accrued—that is to say, the *holding value* is the actual value of a share at any particular time; the *withdrawal value*, on the contrary, is that amount which an association is willing to pay to a stockholder who desires to sever his connection with the association prior to the date at which his share matures. Every association has full regulations on all such matters, as well as on matters pertaining to expenses, notice of withdrawal, and all the methods and processes necessary for safe conduct of the business. The purchase of a share binds the stockholder to the necessity of keeping up his dues, and this secures to him not only all the benefits of a savings-bank, but the benefit of constantly accruing compound interest."

*Conditions out of which the institution arose.*

The character of the institution is especially adapted to real-estate loans and to the service of a home-building constituency in a community where funds for this kind of investment are scarce. In fact, it is out of just such a situation that the Building Loan Association arose. The first organization of the kind about which we have any information was founded January 3, 1831, in Frankford, a suburb of Philadelphia. Philadelphia was a fast-growing industrial center. Frankford was an industrial suburb. As compared with other large cities, Philadelphia has little interest in public institutions; the center of interest for a Philadelphian is his home. It is not strange, therefore, that the home-building corporation found its first development there. The laboring population at that time could obtain little aid from established institutions; reliance on future savings, as part security for a loan, was not looked on with favor. The Oxford Provident Building Association was organized to meet the demand for funds for home building among people who relied on wages for income. It was not until a decade later that the success of the Frankford institu-

tion commended the general adoption of such a plan to meet the demands of other home-building constituencies. Between 1840 and 1850 the Building Loan Association took a place among the financial institutions of most of the industrial centers. The great growth of associations of this kind came later; their numbers gradually increased till, in the latter part of the century just closed their popularity began to decline. This was largely due to the fact that the savings-banks and other financial institutions had accumulated such enormous investment funds that interest on well-secured loans fell below the rate which would make the special building fund profitable to its members. The savings-banks, especially, devised plans for application of savings to the reduction of principal in such a way that they found a safe plan of investment and could offer a low interest rate.

In 1893, at the time the special report was made to the Government by the Department of Labor, there were in the United States 5,838 associations with assets amounting to something over $500,000,000. Through the aid of the 5,440 associations reporting to the Commissioners of Labor, 314,755 homes and 28,459 other structures had been built.

*Magnitude of business transacted.*

The history of the loans showed only 8,409 foreclosures, with a loss of only $449,599, or less than 1 per cent for the entire life of the companies. The magnitude of the business transacted, together with the stability and success of their undertakings, suggest a more detailed description of financial plans.

*Plans for making loans.*

As stated before, loans are usually confined to members. While this is the general rule, it finds variance in some of the companies when there is no demand from members for loanable funds. From the stockholders two classes of security are taken, viz., (1) mortgage liens on the property to be improved, and (2) collateral deposits of stock in the association. Usually, however, the holders of unencumbered shares may obtain temporary loans on security of their stock alone to the

amount of its withdrawal value. There are about 70 plans employed for the making of loans among the various companies. A few of these associations loan money to the members at a fixed rate without premium. These usually give the privilege of obtaining loans in order of application or by lot. In most cases the loanable funds are put up at auction and sold to the highest bidder. One of the favorite plans of auction sale is the following: Interest is set at a fixed rate (let us say 12½ cents per week on $100). A member secures a loan of $1,000. To do this he subscribes for 5 shares of $200 each, which entitles him to become a bidder for the amount desired. He then enters the field of competition at an open meeting of the association, offering to pay a certain number of weeks' interest in advance. Let us assume that he gets the money on a bid for prepayment of 25 weeks' interest. The borrower would then receive $1,000, less $31.25, the amount covered by this bid, or a net sum of $968.75. Then for the first 25 weeks he would be exempt from interest payments, after which he would pay the regular interest contracted for. By a number of plans loans are awarded to stockholders bidding a premium on the stock instead of competing for loans by advance of a definite amount of interest. One of the most used of these provides for a premium to be paid in the nature of a fixed percentage of dues—the amount bid to be added to the regular monthly dues on the stock. In this case the borrower receives the full amount of the loan and pays an interest rate established by the rules of the association. To illustrate: A person wishes to obtain $2,000. He becomes an applicant for 10 shares of stock which have a maturing value of $200 each. Attending the meeting for the auction sale of money to be loaned, he makes a bid by which he agrees to pay the regular dues of $1 per share per month and 10 per cent addi-

*1. Loans at a fixed rate by lot.*

*2. Sales at auction—Advance of interest.*

*3. Award to bidder of highest premium on dues.*

tional as premium. That is, on 10 shares he will pay $10 per month dues, $1 per month premium, and interest on his loan at the rate of 6 per cent per annum (if that is the established rate), or $10 per month interest. The $2,000 will cost him $21 per month until the stock matures, by application of dues and profits, when he may cancel his loan by surrender of his stock if he chooses. By another plan the interest payments are proportionally reduced with each application of dues to principal. In this case the member foregoes his right to participate in the profits of the association. Again, the interest rate may be reduced periodically. The variety of plans for maturing loans is such that chapters might be written without exhausting all the details. The illustration as given will serve as an *exposé* of principles. A more complete analysis will be found in the report above referred to and in the special treatises on the subject.

*Plans for the distribution of profits.*

An interesting feature of the Building Loan Association is the plan for the distribution of profits. It has already been said that the dues and profits are added to the maturing or book value of shares held by members. That is to say, the amount of the earnings of the company after payment of expenses is distributed to the credit of the balance due to the company on deferred stock payments. The application of items of profit, therefore, hastens the time when the borrower may surrender his stock in full payment of his loan. With a company having only one series of stock—i. e., a company which terminates with the completion of the stock payments of its members and the consequent maturity of its loans—the plan of profit-sharing may be a comparatively simple one. Let us suppose that a company were organized with 1,000 members, each holding one share, the maturing value of which will be $200. If each member pays $1 at the time of taking out the stock, and then pays dues at the rate of $1 per month till the stock matures; if, also, interest on loans is fixed at 6 per cent per

annum, payable monthly, then at the time of organization the company would have in its treasury $1,000. At the end of each month $1,000 more would be added by payment of dues. In estimating the book value and time of maturity of the stock, however, interest received on loans would have to be reckoned with. At the end of the first month the amount paid into the treasury would be $1,000 + $5 interest on the loan of the month before. This $1,005 would be loaned at 6 per cent interest payable monthly, as a result of which the treasurer would receive $5 + $5.02, or $10.02 in addition to the $1,000 dues. Again, this $1,010.02 would be loaned at 6 per cent. At the end of three months the return would be $5 + $5.02 + $5.05, or $15.07 in addition to the $1,000 payments of members. Assuming, therefore, that the borrowers would pay the expense of making loans, and that the entire amount received were put at interest, the dues and profits for the year would be as follows:

| LENGTH OF INVESTMENT. | Amount of *dues* paid in by members each month. | Amount of *interest* paid each month. | *Total* amount paid in each month. | Total book value of each share. | Profits per share. |
|---|---|---|---|---|---|
| 1st month. | $1,000.00 | $5.00.*2* | $1,005.00.*0* | $1.00 | $.005 |
| 2d " | 1,000.00 | 5.02.*5* | 1,010.02.*5* | 2.01 | .01 |
| 3d " | 1,000.00 | 5.05.*0* | 1,015.07.*5* | 3.03 | .03 |
| 4th " | 1,000.00 | 5.07.*5* | 1,020.15.*0* | 4.05 | .05 |
| 5th " | 1,000.00 | 5.10.*0* | 1,025.25.*0* | 5.07 | .07 |
| 6th " | 1,000.00 | 5.12.*6* | 1,030.27.*6* | 6.10 | .10 |
| 7th " | 1,000.00 | 5.15.*2* | 1,035.52.*8* | 7.14 | .14 |
| 8th " | 1,000.00 | 5.17.*7* | 1,040.70.*5* | 8.18 | .18 |
| 9th " | 1,000.00 | 5.20.*3* | 1,045.91.*8* | 9.22 | .22 |
| 10th " | 1,000.00 | 5.22.*9* | 1,051.13.*7* | 10.28 | .28 |
| 11th " | 1,000.00 | 5.25.*5* | 1,056.39.*2* | 11.33 | .33 |
| 12th " | 1,000.00 | 5.28.*1* | 1,061.67.*3* | 12.39 | .39 |
| Total .... | $12,000.00 | $61.67.*3* | $12,397.22.*9* | | |

In this the problem is simply one of computing and compounding interest on loans made, and dividing the total interest received during a definite period by the number of

shares outstanding, thus giving the rate of profit per share. By adding profits to dues paid in, the *book valuation* is determined. The *withdrawal valuation* is fixed by the rules of the company. It is usually something below the *book valuation*, and for this another column may be added and the office record is complete. With interest and other tables at hand, the entries may be made by the secretary at the end of each month before the monthly meetings.

When, however, new series are started each year, the computation becomes more complex. There are between 20 and 30 plans employed by the associations for the distribution of profits to serial stockholders. One of these plans is the same as that commonly used for the determination of partnership profits when partners have entered a business at different times, each series representing a partner. To illustrate: Let us suppose that an association whose monthly dues are $1 per share has three series in force at the end of the third year, with a fourth series just issued; that the number of shares in each series and the book valuation per share at the end of the third year are as follows:

| | | |
|---|---|---|
| (1) Series 1...... | 500 shares, value per share...... | $38.87 |
| (2) Series 2...... | 600 shares, value per share...... | 25.27 |
| (3) Series 3...... | 400 shares, value per share...... | 12.32 |
| (4) Series 4...... | 4,500 shares, value per share...... | 00.00 |

Let us suppose that the net profits for the fourth year are $3,000. It is evident that a fair distribution of profits must have reference to the value of the shares. To determine this, however, the profits of previous years are also taken into consideration. The total net profit of the company up to this time we will assume to be $5,325. The problem is to find the earnings on each share at the end of the fourth year. Justice to all parties requires that the holdings of members be reduced to some common basis. Since each stockholder pays in $1 per month, the first dollar paid on Series No. 1 has run for 48 months; the sec-

ond, 47 months; the third, 46 months, etc., to the last dollar, which has run only 1 month. The average length of time that each dollar has run in this series, therefore, is $\frac{48+1}{2}$, or $24\frac{1}{2}$ months. In Series 2 the first dollar paid has run 36 months, while the last has run but 1 month. The average length of time for this series is found to be $\frac{36+1}{2}$, or $18\frac{1}{2}$ months. The average for Series 3, by the same process, is found to be $\frac{24+1}{2}$, or $12\frac{1}{2}$ months, while the average for Series 4 is only $\frac{12+1}{2}$, or $6\frac{1}{2}$ months. The stockholders of the first series have paid in \$500 per month. This multiplied by 48 will give the total amount invested by them. Members holding stock in the second series pay in \$600 per month, which amount multiplied by 36 gives their capital investment. The third series pays \$400 per month, and is multiplied by 24. The fourth, paying \$500 per month, is multiplied by 12. All of these shares are reduced to a \$1 investment level by multiplying the number of dollars paid in in each series by the average time that the series has run. The result is as follows:

| | | | |
|---|---|---|---|
| Series 1.......... | \$500 × 48 = | \$24,000 × $24\frac{1}{2}$ = | \$588,000 |
| Series 2.......... | 600 × 36 = | 21,600 × $18\frac{1}{2}$ = | 399,600 |
| Series 3.......... | 400 × 24 = | 9,600 × $12\frac{1}{2}$ = | 120,000 |
| Series 4.......... | 500 × 12 = | 6,000 × $6\frac{1}{2}$ = | 39,000 |
| Total investment for one month.......... | | | \$1,146,600 |

Using the total \$1,146,600 as a common denominator, an apportionment is made:

Series 1, $\frac{588,000}{1,146,600}$ or $\frac{980}{1,911}$ × \$5,325 = \$2,730.77 ÷ 500 = \$5.46 per share.

Series 2, $\frac{399,600}{1,146,600}$ or $\frac{666}{1,911}$ × 5,325 = 1,855.81 ÷ 600 = 3.09 " "

Series 3, $\frac{120,000}{1,146,600}$ or $\frac{200}{1,911}$ × 5,325 = 557.30 ÷ 400 = 1.39 " "

Series 4, $\frac{39,000}{1,146,600}$ or $\frac{65}{1,911}$ × 5,325 = 181.12 ÷ 500 = 0.36 " "

Distributing the profits thus determined to the several shares their *book values* will be:

| | | | | |
|---|---|---|---|---|
| Series 1 | $48 + | $5.46 = | $53.46 | per share. |
| Series 2 | 36 + | 3.09 = | 39.09 | " " |
| Series 3 | 24 + | 1.39 = | 25.39 | " " |
| Series 4 | 12 + | 0.36 = | 12.36 | " " |

In apportioning the profits by this plan it is necessary to allow compensation for stock sales made at different times, so that all parties within one series may be on a common footing. Other plans of profit-sharing will not be discussed here.

*Withdrawal plans.*

The theory of a share in a building loan association is, "that when the periodical dues paid thereon, together with the profits earned thereby, amount to the ultimate, or, technically, the *maturing value* of the shares, the holders shall be entitled to receive, in cash, such value, if the shares have not been pledged for loans; if pledged for loans equal in amount to the maturing value, then the loans shall be canceled; if the loans do not equal the amount, the maturing value of the pledged shares, then the holder shall receive in cash the difference between the amount of the loans and the maturing value of the shares." It sometimes happens, however, that a stockholder may wish to withdraw before the maturity of the series in which he is interested. This makes the adoption of some plan necessary to render substantial justice. This is usually determined by the rules of the company at the time of its organization and becomes a part of the investment contract. One plan, employed by about 200 associations, allows the withdrawing stockholder to receive only the dues paid in on his own shares, the profits earned being retained for the benefit of those who remain until the series is closed or matured.

By another plan the withdrawing stockholder receives dues paid in together with interest on the amount at a fixed rate; this, however, being below the rate earned by the stock in his series.

Again, the full profit earned may be paid on withdrawal, subject, however, to such fines, penalties, and dues unpaid as may stand on the books, together with a withdrawal fee prescribed by the rules of the company. A common practise is to allow a definite proportion of the earned profits, as, for example, 75 per cent, the remainder reverting to the series. This proportionate rate may be conditioned on the time that the stock is run, the percentage of discount diminishing with the length of time of the investment.

There are 12 distinct plans described in the Government report above referred to. Provision is usually made in the constitution and by-laws of companies for the giving of notice by stockholders desiring to withdraw. It is also usually provided that only a percentage of funds received may be used to pay withdrawals. If notices of withdrawal call for more than the amount available for this purpose, the applicant must wait until there are sufficient funds in the treasury. It is this feature that protects the building and loan association from danger of bankruptcy. When all expenses are paid by fees and charges made at the time that loans are contracted for or stock is issued, the company can not become a bankrupt for the reason that no fixed or current charges can arise which will shorten the life of the institution; there are no current liabilities to meet. Obligations are only to members or stockholders.

# CHAPTER XII

## THE COMMERCIAL BANK

In getting together materials and organizing service for business on a modern basis, of highest importance are arrangements for current funds—cash resources. These are necessary to exchange. Neither mechanical equipment, supplies, nor skilled labor can be obtained to advantage without a working cash capital. He who is prepared to furnish such funds is equipped to render a service for which the farmer, the manufacturer, and the merchant—all who are engaged in the active management of industry—are willing to pay. To illustrate: Brown has purchased a mill and water-power conveniently located on the edge of the great wheat belt. For this he has paid $150,000, but many of the machines are antiquated, and expensive to operate. Sixty thousand dollars more are expended in improvements. He now has his mechanical equipment. Still there is much lacking. Grain must be purchased; labor must be employed and wages paid; transportation charges must be settled, and current expenses must be met. All these outlays must be made before return may be had on sales of goods purchased. He must look for profits for the year in the margin of gain between total outlay and total receipts from sales measured in terms of the common standard of value. The outlay must be made weeks before return is had, and this, too, must be commensurate with the size of the working plant and the volume of business handled. The element of time necessary to the

*The service of the commercial bank to a community.*

*Necessity for current funds in the capitalization of industry.*

most advantageous production and distribution of goods, requires that he provide a working capital (current funds) of about $100,000.

*Obstacles to business without a bank.*

The question now presents itself, How shall these funds be carried? Shall he lay in a stock of money? A delivery of gold will satisfy demands on contracts for labor and material; but the dangers entailed in keeping such an amount of money as is needed, the breadth of the field covered in his business transactions, the variety of interests involved, and the number of payments to be made, would render this a highly expensive form of cash assets. Every consideration disposes him toward a more economical form of "current funds," if such may be had. But the miller is not alone in this desire. His is not the only business interest in the community. Falls City, the place where Brown's mill is located, is a town of 10,000 inhabitants. There are a number of other industries, each of which is in need of working capital. The town is a local trade center, and merchants of every class are there with stocks of goods to supply the wants of country and town. If money were the most available means of effecting exchanges, each would suffer the same inconvenience—each would be under the necessity of keeping a "strong box," fire-proof and burglar-proof; even then they would not be secure against loss. Current funds are an absolute necessity; with a stock of money provided, each would have to keep a guard, for no box is too strong to be "cracked" with modern instruments, and there is no combination lock that may not be "worked" if time and opportunity be given. The expense and risk of the money system would not end here. Brown is doing a business that would involve the handling of from $5,000 to $20,000 per day; much of this outlay is made in transactions of small amount; it would be necessary to have a comparatively large, highly paid, and responsible clerical force to count out the money and make change. The business organization of the whole

place would be encumbered with expense and inconvenience, and transactions at a distance would be made extremely difficult. Such conditions as these furnish the business opportunity for such service as the commercial bank is organized to render. The service and the profits made and the mutual advantages gained by the first bank in Falls City suggests the organization of another, and still another, until at the present time there are six banks in the place, all doing a thriving business.

*1. Bank furnishes current funds in the form of "bank credit."*

With this equipment, instead of carrying a large amount of money in purses and vaults, and keeping a guard and a large corps of money-changers, the miller has on his desk a "check-book." His $100,000 "cash" capital is divided between his local town and New York. Temporarily he has $50,000 in gold locked up in "safe deposit." This he withdraws and sends by express from New York to Falls City. On arrival at his place of business he orders the express company to deliver the gold to the Falls City Bank; with this he buys a bank account of $50,000—i. e., he "deposits" the amount, and receives credit to like amount "on the books of the bank."

*2. Exchanges "bank credit" for money.*

He also takes all moneys received by him in the course of his business to the Falls City Bank and exchanges them for bank credit. Now, when grain is purchased from the farmers around, or from the local dealer, or when wages are paid or machinery and supplies are bought, or transportation charges are to be settled, Brown signs a check for the amount involved. He draws against Falls City or New York, as may be to his greater advantage. For local payments he makes out a local check; if an Eastern account is to be settled, he checks against New York. It costs him nothing to pay in New York what he owes there, whereas he would have to pay "exchange"—i. e., cost of collection—if he sent a Falls City draft.

But the bank renders another service. Nearly all payments made to the miller for goods sold are in the form of credit. "Cash" sales are for checks and drafts of customers; sales on "time" are exchanges of goods for notes or credit accounts—credit obligations of purchasers to pay money at a future time. None of these may be used to advantage by Brown as "current funds"; neither can he present them for payment at the time and place specified; nor can collections be made to advantage by Brown personally. The places are widely scattered; it is important also that he give his time to other matters of business than the collection of checks and drafts and credit obligations. He therefore writes his name across the backs of checks and drafts (indorses them) and turns them over to the bank. The bank not only assumes to attend to their presentation and collection, but it credits Brown at once in full with the amount turned over. The miller has a pass-book—i. e., a book of convenient size to be carried in his pocket—in which the receiving clerk at the bank enters the amount of the checks and money received "for deposit" on the debit side. The debit side of this book represents Brown's credit at the bank—the amount that the bank is indebted to Brown. Periodically—say once a month—this pass-book is turned over to the bookkeeper at the bank, and he enters on the credit side the amount of items paid by the bank on Brown's order. The bookkeeper then strikes a balance and makes a new entry of the amount still owing by the bank on the debit side. Each afternoon Brown's bookkeeper makes a memorandum of all the money and checks received in the course of the day's business on what is known as a "deposit slip." This, together with money, checks, and pass-book, he takes to the bank and hands to the receiving teller for a new entry to Brown's account. In exchange for the checks, drafts, and notes (commercial paper) sent in for "deposit," Brown receives "bank credit,"

*3. Allows its customers to convert "business credit" into "bank credit."*

the bank relying upon Brown's guarantee of indorsement on the commercial paper deposited.

If, however, Brown does not wish to assume the responsibility of indorsing the checks and drafts "for deposit," or if the bank does not care to exchange its credit "deposit" for these checks, drafts, and notes on even terms; or, again, if there are notes and accounts that have been obtained by Brown in the course of his business that he does not care to exchange for "cash," these may be turned over to the bank upon Brown's indorsement "for collection." The bank in this case does not at once give Brown the right to draw against it. It does not exchange anything for these credits so turned over. It simply assumes to act as Brown's agent for the purpose of presentation and collection, and when collection is made sends notice of the fact.

*4. Serves as agent for the presentation and collection of "business credit."*

The funds so held are trust funds, and they remain "in trust" with the bank until order is received from Brown to place them to his general account; in which case, if the bank acts upon his order, an exchange is made of "bank credit" of like amount for "trust funds" held, and the trust ended. It may be to Brown's advantage at times to withdraw a certain amount of money from the bank; in other words, to exchange "credit" to his account for "money," which amount so withdrawn may be placed with the bank in trust for some special use or business purpose. This will also place the bank in relation of trustee instead of debtor, and the funds so held will be held for Brown and subject to Brown's order and direction; they can not be used by the bank as assets of its own. The bank may in many other ways serve the business community as trustee in the caring for and handling of current funds.

*5. Acts as trustee.*

Brown's New York bank account may run low, and he may wish to increase it. For this purpose he may draw out

gold from the Falls City Bank—i. e., may demand payment of his deposit in gold or other "legal tender"—and transfer this to New York by express. But if he has in mind his own business advantage he will not withdraw gold or other forms of money. It will cost him, say, $1 for $1,000 to ship money to New York. He will instead seek "exchange." He asks the cashier how much he will charge for a check of the bank on *its* New York account. The bank could never ask more than the cost of sending gold, for in such case the customer himself would "draw" on the bank. It will usually ask less. The bank is able to do this because demands are made in New York for money to be sent to the West. If checks are drawn for remittance to the West, then, on settlement between the various banks, only so much money will have to be sent from one to the other as represents the balance due. The Falls City Bank may have on its own counter $10,000 of "exchange" on New York, or may know where it can obtain that amount at par. If Brown wishes to send $15,000 to New York, and the bank has, at par, $10,000 of New York exchange, at $1 per $1,000, it will cost only $5 to send the balance. The bank could therefore sell $15,000 of exchange to Brown at $6 and make $1 profit on the transaction, while Brown would be $9 better off than if he had shipped the money. He would prefer to pay the $6 rather than spend the time necessary to find exchange elsewhere, even though he might save 50 cents or $1 by so doing. The sale is therefore made. Brown makes out his check against the Falls City Bank "on account of New York exchange" for $15,000, and in exchange therefor becomes the owner of a $15,000 cashier's check, or draft, of the Falls City Bank on its New York "reserve agent."

6. *Sells exchange.*

In the course of his business Brown may have contracts for the delivery of grain in Liverpool. As a matter of advantage in purchase he may wish to go to the interior of Manitoba for wheat. To purchase there, it may be to his

interest to have money instead of bank credit. He withdraws from the bank at Falls City $5,000 in paper money—he does not care to be encumbered with the weight or run the extra risk of carrying gold. He finds, however, that the farmers are not acquainted with this sort of "paper," and do not care to take it in exchange for wheat. He still does not find it convenient to carry the necessary amount of coin, and therefore goes to a Canadian bank for the purpose of exchanging American "bills" for Canadian "paper money," a form of credit that the farmers have confidence in, and are willing to accept as a par value with gold. But the Canadian bank will not trade without profit. It offers to buy American bills at 98 cents. In exchange for $5,000 of American money, therefore, Brown receives $4,900 in Canadian bills, which he takes out into the Manitoba fields and exchanges for wheat. He has paid $100 exchange on Canadian money, but has had a service rendered him by the Canadian bank that is worth much more than the price paid.

*7. Buys and sells foreign moneys.*

On his way homeward he stops at Deadwood, where he finds a merchant who wishes to buy flour. The trader's business is to furnish supplies to mining-camps. He has little money, but possesses a stock of bullion which he has received in the course of trade. Brown offers to sell flour F. O. B. at the market price at Falls City, and to receive in payment bullion at the market rate in New York. The bullion is consigned to his New York bank, and on its arrival Brown is given credit on his account at the market price of silver, less commission. Returning to Falls City, he finds awaiting him there notification of the credit given, and he thereupon places on board the cars, billed for Deadwood, the amount of flour contracted for. In this way the sale is made to the Deadwood merchant as readily and conveniently as if he had possessed gold or paper money instead of bullion of uncertain quality.

*8. Acts as bullion broker.*

The bank has served Brown and his business by relieving him of the expense and risk of keeping current funds in the form of money. It has furnished him with a kind of credit that will serve him more conveniently for cash. It keeps his credit accounts and makes collections, through its agents, of all checks received by him in his business. It acts as his agent for the collection of notes and bills. It serves as trustee in matters where he may gain business advantage through such service. It has enabled him to procure money with which to deal in foreign lands. It has enabled him to dispose of bullion and to trade with those having it as conveniently as if they had coin instead. All these services are of marked advantage not only to Brown, but likewise, by similar arrangement, to all other business in the community. Throughout the country, in fact throughout the civilized world, these institutions have grown up, and by maintaining their own credit engagements with others, men are able to make exchanges of large value by use of credit instead of money. By maintaining its own credit the commercial bank likewise compels its patrons to fulfil their obligations; by giving greater certainty to business judgment and greater facility to exchange, it has become a potent factor in widening the range of commercial industrial enterprise and increasing the opportunities for profit to those who have the ability to avail themselves of industrial and commercial advantage. Such, in brief, are the principal services rendered by the commercial bank to the business community.

9. *Binds together and enlarges business relations.*

But how does the bank profit? Does it charge its clients for making exchanges of "money" for "bank credit"? No. Does it receive compensation for keeping deposit accounts? No. Does it charge for collecting checks on other banks that are received in the course of business and turned in "for deposit"? No. Does it charge for "collections"? In most

*Profits of the bank.*

cases it does not. More than this, it ofttimes pays its customers something for the privilege of performing these services. How, then, can the commercial bank afford to employ a staff of officers and clerks, build and maintain costly business houses and strong vaults, keep guards and watchmen, carry a large stock of coin and bullion of their own with which to meet outstanding credit when demand is made for money, pay mailing expenses and transportation charges, and make other outlays incident to services rendered to the business community? It meets all these charges out of the income of its business. Banks pay large salaries to officers and employees, and they also make a good profit in dividends to their stockholders.

*Profits arise out of exchange of "demand credit" for "time credit."*

The bank obtains a small proportion of its income from sales of exchange, from transactions in coin and bullion and other incidental services, but the principal income, the income upon which the bank relies for its success, arises from the fact that it deals in credit, buys and sells credit. For the purposes of the banker there are two kinds of credit: 1. Demand credit—that which is due at such time as it may be presented for payment, and which bears no interest. 2. Time credit—credit that bears interest (interest being proportionate to the amount of money promised, the length of time that payment is delayed, and the rate agreed on). The chief function of the bank is that of furnishing to business men a kind of funds that will pass current, such credit as will be received in exchange in lieu of money—that is, as "cash." The business community needs current funds—currency. Under more antiquated systems of business, money served the need for currency in exchange. The bank offers a form of currency that will serve them better than money. It offers bank credit—its own promise to pay money on demand.

To make its promises pass current, however, it is necessary to keep enough money on hand to assure the public

that it can meet all demands outstanding. If this is done, if the bank so conducts itself that the business community has *confidence* in it, if, in the judgment of "depositors" and other members of the community, it will at all times be able and willing to meet its promises, then the superior advantages of using bank credit instead of money will cause the community to do nearly all its business with the demand promises of the bank. If the business public know that they can always get gold in exchange for "bank credit," then the obligation of the bank will be considered "as good as gold," the value of the credit promises will be equal to the value of the thing promised. The bank, therefore, must keep such a stock of coin (or legal-tender money) in its vaults as will enable it at all times to satisfy the public that it is ready to meet its promises. The resources that enable the bank at all times to retain the money necessary to maintain its "credit" are usually contributed by its stockholders at the time of its organization.

*Equipment of bank.*

So long as there is no doubt of the integrity and the ability of the commercial bank to pay, it will require only a relatively small amount of money to meet demands. In the case of Brown's business, his bank account may range from $5,000 to $100,000. Here is a widely fluctuating credit, to be sure, and if the bank had to keep $95,000 in its vaults to insure its ability to meet his checks it could profit nothing from serving him. But Brown is not its only customer. The bank has several hundred others. When Brown buys his grain he delivers checks to a hundred different farmers and grain-dealers that are also customers of the bank. Brown's account is simply transferred to others on the books of the bank.

*Money reserve.*

A little gold, or silver, or paper money will be drawn out daily to meet the demands of trade—to make change, perhaps, or to do business out in the country, where the

people do not know enough about the financial standing of business men to be willing to accept checks—but in the daily course of trade about as much money is collected by merchants and bank customers from "outsiders" as is drawn out. This is brought to the bank and exchanged again for bank credit. The amount of coin actually needed, when public confidence is undisturbed, amounts to but a fraction of 1 per cent of the credit currency of the bank outstanding. In times of financial disturbance, when public faith is shaken, it has been found by experience that if a bank continues to meet its obligations as fast as payment is asked, confidence in its ability to pay all demands will be restored before 30 per cent of its outstanding credit has been redeemed. Under all circumstances, therefore, it would not be necessary to carry in money more than 25 or 30 per cent of its deposits.

*Ordinary demands for money.*

With $50,000 money capital invested by the stockholders, the bank will be able to sell from $150,000 to $200,000 of its own credit accounts, and will at all times be able to deliver cash on demand. This is a smaller percentage of "credit" than is usually sold by the banks as current funds "deposit." The Federal law requires a 15 per cent reserve for country banks and 25 per cent for city (reserve) banks; but it allows 9 per cent of the 15 per cent required of the country banks to be deposited in the city reserve banks and to be counted as a part of the reserves of both. With a $50,000 capital held in its reserve a bank could purchase by use of its own credit—make investments—to the same extent that it could, without credit, if it had $200,000 or more of gold in its vaults.

*The bank's salable credit.*

What will the bank do with this $200,000 of disposable credit? The stockholders have invested $50,000 of money in the bank. The bank has $200,000 of disposable credit for investment in other things. It is in the disposition of its credit funds that it builds up its clientage, renders the

highest service to the community, finds its own greatest protection, and makes the greater part of its income. Let us say that Brown sells on the average $50,000 worth of mill product per month. Some of this is sold in Chicago, the remainder in New York and Liverpool. He deals with first-class wholesale houses. But it takes time to deliver goods after a sale is made; then, too, his business arrangement with his customers is that bills shall be post-dated—that is, if a sale is made on January 20, ten days, perhaps, may be allowed after delivery and the bill will be post-dated May 1. This is the date upon which it will be due and payable. It is also a rule of business with him to allow 5 per cent discount from the price stated in the bill for "cash" on delivery. When Brown has a small stock of grain on hand he may be able to meet all the demands of his business and at the same time carry such of his customers as do not avail themselves of the 5 per cent discount. In this case, the miller may be able to get 5 per cent on the "cash" price for the ninety days' delay. But in the fall, when the best milling grains are coming into the local market, Brown may find it to his advantage to buy a large stock; otherwise it may be shipped out of the country, and later he would have to pay Chicago prices for his grain, besides freight charges back again. Now, having made local purchases of grain, he is not in position to "carry" his customers. He therefore goes to his bank and enters into an arrangement whereby he is to turn over to the bank "bills" against his customers for mill products sold; he makes the bank his agent for collection, and at the same time he arranges to borrow from the bank such amounts as he may need in his business (not to exceed 90 per cent of the amount of bills placed in their hands). The amount borrowed from the bank is represented by Brown's promissory note payable on or before ninety days, with interest at 6 per cent per annum until paid. In other words, the bank arranges to sell its credit (a deposit)

*Profits based on investment of credit.*

to Brown in exchange for his interest-bearing obligation to the bank. That is, Brown has exchanged his own promise to pay at a future time for the bank's promises to pay at once; but Brown also stipulates that he will pay an additional sum to the bank, as interest, in consideration for the length of time that his payment is deferred. By keeping a money reserve, the bank is able to sell some three or four times as much of its "demand credit" (deposits) for the "time credit" of its customers (commercial paper) as its stockholders had money invested in the bank, and gets an income of interest on its "loans" of credit, just as it would have done had it "loaned" money instead. In this appears the answer to the question, Why does the bank keep Brown's account and collect his checks free of charge, besides doing various other services for him at its own expense? Obviously it is because by so doing it will be able to do other business out of which a profit may be realized. Brown's first deposit may have been created by a sale of money to the bank in exchange for "bank credit." Again, it might have arisen from a transfer of the "credit" of some one else for "bank credit." In either case the bank has gained a business advantage. If money is obtained, this adds to the reserve; if the credit of others, then their credit funds are being reduced and new demands created for bank credit. The ones from whom the checks were received had bought "deposits." These are being exhausted. More than that, Brown is constantly exhausting his own account. When further funds are needed by him the bank will be able to sell its credit and make a profit on the sale.

*Kinds of investment that a bank may safely make.*

This raises another question, What kind of purchases may a bank make with its credit? Its business is organized to serve a class of people engaged in trade and production. With them it must deal and out of this service it must obtain its profits. But while the bank serves the community, it must at the same time serve itself. For the bank

there are only three kinds of property in which its credit may be invested with safety and profit while serving the industrial community: 1. It may sell its credit (deposits) *for money*. That is, if a merchant or manufacturer has taken in money that he may not find convenient for use in his business, he deposits it—takes it to the bank and sells it for "bank credit," which he finds more convenient. The bank's interest in this exchange lies in its ability not only to give bank credit for the money received, thereby maintaining a constant flow of coin, but by thus strengthening its money reserve to sell some two, three, or four times as much of credit on the sale of which it may make a profit. 2. It may sell its credit for *such credit "securities" and credit rights as it may deem necessary to strengthen its reserve*, and relieve it from the necessity of carrying a larger sum of money. These investments are usually in some form of low-rate interest-bearing obligations. They may be in the form of Government bonds or securities that may be realized on at any time in the open market without loss of principal invested, and at the same time bring in a small current income. They are usually deposits in other banks (as with reserve agents), or in the form of "call loans on collaterals"—investments that may be realized on at once, investments that usually bear a low rate of interest, but which grow out of commercial transactions. 3. It may sell its credit for commercial paper—*the short-time interest-bearing or discountable credits* that arise in the course of the business of its customers. The manufacturers and merchants of a community are constantly selling goods "on time." They, however, sell at such a margin of profit that, in case funds are needed in their own business, they may dispose of the bills at a discount, convert them into current funds, and purchase their stock for manufacture and sale rather than hold the accounts for final payment with interest. Their business is that of production and sale of goods. Credit to them is only one of the means employed in the

equipment of their plant for larger profits. Credit is a convenient means of exchange, and it is out of the exchange that the profit is to come, and not from the income in the form of interest on deferred payments. The bank, on the other hand, is organized for the purpose of making a profit on the purchase and sale of credit; but the only kind of high-rate interest-bearing credit that it may safely handle and at all times maintain its own stock unimpaired are the short-time obligations of its customers. The observance of this principle is a condition necessary to success. This is imperative, on account of the opportunity which is thus afforded the bank to press for payment claims which may become doubtful through the shifting fortunes of merchants. It is also to its advantage to maintain a constant flow of payments from its commercial credit assets due as a means of protecting its money reserve in case this is at any time threatened by those who hold deposit accounts.

According to the report of the Secretary of the Treasury for 1899, the amount of capital stock paid in by the 3,595 national banks (September 7) was $605,772,970. The amount of money reserve actually held at that time was $487,524,937. But besides the capital stock paid in there were $248,449,235 of surplus and $102,066,430 undivided profits—a total capital fund of $956,288,635. It appears, therefore, that an average of only 51 per cent of the capital funds were actually held in money reserves, while against this money reserve there were outstanding $2,450,725,598 of individual deposits, and about $1,000,000,000 of deposits in other banks, $414,000,000 of the latter being with authorized reserve agents. There were besides some $200,000,000 of national bank-notes outstanding. Assuming that $400,000,000 of the deposits in other banks were drawing interest, the credit sold by those banks from which an income was derived was over $3,000,000,000, or about six and one-half times the amount of money reserve actually held.

The income-producing investments made in exchange for their own credit (deposits and notes) were as follows:

| | |
|---|---|
| Commercial paper | $2,496,751,251 |
| Deposits in other banks on interest (estimated) | 400,000,000 |
| United States bonds to secure circulation | 229,639,610 |
| Total | $3,126,390,861 |

If we may assume that the commercial paper averaged 5 per cent, United States bonds 3 per cent, and interest on deposits in other banks 2 per cent, then the total annual income on these investments would be:

| | |
|---|---|
| Commercial paper | $124,837,562 |
| Interest on bonds | 6,884,188 |
| Deposits in banks on interest | 8,000,000 |
| Total | $139,721,750 |

As stated before, the bank's income is not confined entirely to sales of its own credit. Besides being an investor, the banker is a merchant and broker—dealing in bullion, coin, bills of exchange, bonds, and securities. He is also an agent for the collection of bills and notes. He may likewise be a trustee. All of these functions, however, have to do with money and credit in their uses as capital—with the financial operations and activities involved in the purchase and sale of goods; out of them all comes the gross income of the bank, from which are to be obtained its expenses and profit.

# CHAPTER XIII

## THE TRUST COMPANY

A WELL-ORGANIZED system of credit involves a great many fiduciary relations. It is to give greater certainty and facility to the administration of these that the *trust company* is organized. To make the more common trust relations concrete, as well as the more common demands for their administration, let us recall the experience of a retired banker. At an advanced age he withdraws from cares and responsibilities of management; he intends to devote the remainder of his life to the comforts of home and the care of his own properties and investments. He has not been long in retirement, however, when an old friend asks to be allowed to insert his name in his will as executor. He consents. A few months elapse when the probate judge of his district approaches him. An estate has been in his court for several years; the administrator, a son of the deceased, has not pushed the settlement as fast as his position demanded; the other heirs complain not only of delay and waste, but also that the administrator has employed a portion of the assets for his own purposes; on being cited to appear and render an account of his trust, he disclaims misappropriation of funds, but avers that his own business requires such a portion of his time that he can not give proper attention to the estate. The judge urges the banker's acceptance of appointment as administrator to wind up the estate as rapidly as the interests of all parties will permit. Presently another trust

*The service of the trust company.*

is thrust upon him in such a manner that he can not refuse it. A neighbor has died, leaving an infant daughter. By will he had appointed the banker guardian of his child and trustee of his estate for her benefit. Decedent held interest in a number of industrial concerns; these must be sold and settled and the proceeds invested in such a way that safe and sure income will be realized for the education and support of the child. It will be years before his ward will come to such an age that she will be competent to form business judgments of her own. In the meantime, if he accepts the trust, he will be held to account for the proper care of the estate as well as care of the child.

One advantage is found in the administration of these trusts: they all call for the exercise of the same kind of conservative judgment, and they fit well into the banker's own business—investment; he now finds himself quite as busy with his new duties as he had been before his retirement; in fact, so fully employed is he in looking after the demands of trusts imposed that his occupation is growing irksome. Such demands, however, increase. The failure of a large private bank brings a further request for his services. The many creditors, as well as the court having the estate in charge, urge his acceptance of appointment as receiver. They point out his special fitness; his acquaintance with the men and business firms involved; his knowledge of the value of properties and securities held. An experience such as his seems indispensable to an equitable settlement. The parties concerned propose to allow him to employ such clerical service as he may wish, if he will but exercise the business judgment necessary to the proper adjustment of their interests. He accepts this trust also, but, in accepting, it becomes necessary for him to open a down-town office where he can be in regular attendance during a few hours each day and give attention and direction to affairs. Though clerical service is competent to manage the details, an ex-

*The economies of the trust company.*

perienced and capable financier must pass judgment upon all matters involving discretion.

It is out of just such situations as this, such increasing demands for the competent management of trusts, that the first trust companies arose. The trust company is primarily an American financial institution. It was in this country that it had its origin. Ours was a new society and one in which business activity was a very prominent feature. In America there were comparatively few men of wealth and ability who belonged to what might be called an intelligent, thrifty, leisure class. But in Europe a large proportion of estates were held, and men found among their fellows those who had the time, intelligence, and financial standing necessary for the safe and successful managing of trusts. In America the conservative, well-established, wealthy class—the class whose time and wealth were not involved in the turmoils of trade and the risks of business venture—was so far wanting that some specially created agency to perform these services became necessary to the establishment and maintenance of trust relations. But the necessity that gave birth to the invention provided us with a very superior instrument—a financial institution as far in advance of the old-time personal trustee as the modern machine is ahead of hand labor.

*Origin of the trust company.*

Quoting from the Revised Statutes of New York, the term trust company signifies "any corporation formed for the purpose of taking, accepting, and executing such trusts as may be lawfully committed to it, and acting as trustee in the cases provided by law." To give a more comprehensive notion of the constitution of the trust company and of the care exercised in its formation, the manner of organization in that State may be described: "Thirteen or more persons," says the statute, "may form a corporation to be known as a trust company. Such persons shall, under their hands and seals, execute and acknowledge an *organization certificate* in

*Methods of organization—Legal steps necessary.*

duplicate, which shall specifically state: (1) the name by which the corporation shall be known; (2) the place where its business is to be transacted; (3) the amount of its capital stock and the number of shares into which the same is to be divided—at least $100,000 is required for cities containing less than 25,000 inhabitants, $150,000 for cities containing over 25,000 to 100,000 inhabitants, $200,000 for cities containing from 100,000 to 250,000 inhabitants, and $500,000 for cities containing more than 250,000 inhabitants; (4) the name, residence, and business address of each member of the corporation; (5) the term of its existence not exceeding fifty years; (6) the declaration that each member of the corporation will accept the responsibilities and faithfully discharge the duties of a director therein if elected to act as such."

*1. The organization certificate.*

After the acknowledgment of this *organization certificate, notice of intention to organize* such a trust company must be published at least once each week for four consecutive weeks in a newspaper (to be designated by the superintendent of banks) published in the city or town where the proposed company is to be located. "Such notice is required to set forth the names of the proposed corporators, the name of the proposed corporation, and the location of the same, as set forth in the organization certificate. If there is any trust company or trust companies organized and doing business in such city, a copy of such notice shall also be sent to each trust company so organized and doing business at least fifteen days before the filing of the organization certificate."

*2. Notice of intention to organize.*

Within sixty days after the acknowledgment, one of the duplicate copies of the certificate of organization must be filed in the office of the County Clerk of the county wherein the trust company proposes to locate and do business. The other must be sent to the office of the Superintendent of Banks

*3. Filing in office of Superintendent of Banks.*

of the State, together with evidence of publication and service of notice before described.

"If such certificate is in due form and duly executed according to law, and is accompanied by evidence satisfactory to the superintendent of the proper publication and service in good faith of such notice, he shall forthwith indorse the same over his official signature, 'Filed for examination,' with the date of such indorsement."

4. *Publication.*

"When the certificate shall have been filed, the superintendent shall ascertain *from the best sources of information at his command* (1) whether the general fitness for the discharge of the duties appertaining to such a trust of the persons named in the certificate is such as to command the confidence of the community in which such trust company is proposed to be located, and (2) whether the public convenience and advantage would be promoted by such an establishment."

5. *Examination as to fitness.*

Further, "The Superintendent of Banks shall, before issuing the certificate of authorization to any corporation, examine or cause an examination to be made in order to ascertain whether the requisite capital of such corporation has been paid in *cash*; and if it appears from such examination that such capital has not been fully paid in cash, the certificate of authorization shall not be granted and no such corporation shall commence business until such certificate of authorization has been granted. If so satisfied, he shall, within sixty days after such certificate has been filed with him for examination, issue under his own official seal the certificate of authorization required; . . . . which certificate so issued by him shall authorize the persons named therein to become a trust company as designated in the organization certificate."

6. *Authorization to begin business.*

When the *certificate of authorization* is given by the Superintendent of Banks, the persons named and their

successors become a corporation, and in addition to the general powers granted to corporations within the State, have

*7. Trust powers granted.*

the following powers: (1) To be appointed and to accept appointment of executor or of trustee under the last will and testament, for administrator with or without will, in case of the estate of any deceased person, and to be appointed and to act as trustee of the estates of lunatics, idiots, persons of unsound mind, and habitual drunkards. (2) To take and execute any and all such trusts and powers of whatsoever nature or description as may be conferred upon or entrusted or committed to it by any person or persons, or any body, political corporation, or other authority, by grant, assignment, transfer, devise, bequest, or otherwise, or which may be entrusted to it or transferred to it or vested in it by order of any court of record or any surrogate, and to receive and take and hold any property or estate, real or personal, which may be the subject of any such trust. (3) To take, accept, and execute any and all such legal trusts, duties, and powers in record, and the holding, management, and disposition of any estate, real or personal, and the rents and profits thereof, for the sale thereof, as may be granted or confided to it by any court of record, or by any person, corporation, municipality, or other authority, and it shall be accountable to all parties and interests for the faithful discharge of every such trust, duty, or power which it may so accept. (4) To act under the order of appointment of any court of record as guardian, receiver, or trustee of the estate of any minor, the annual income from which shall not be less than $100, and as the depository of any moneys paid into court whether for the benefit of any such minor or other person, corporation, or party. (5) To accept trusts from and execute trusts for married women in respect to their separate properties and to be their agent in the management of such property, or to transact any business in relation thereto. (6) To receive deposits of trust moneys,

securities, and other personal property from any person or corporation.

These we may call the general trust powers conferred. In addition, there are what may be styled the *special* trust powers, growing out of modern methods of corporation finance, and trust service demanded in the organization and management of large business corporations. These are as follows: 1. The power to act as the fiscal or transfer agent of any State, municipality, body politic, or corporation, and in such capacity receive and disburse money and transfer, register, and consign certificates of stock, bonds, or other indebtedness. 2. The power to act as trustee under any mortgage or bond issued by any municipality, body politic, or corporation; and, 3, accept and execute any other municipal or corporate trust not inconsistent with the laws of the State.

*Fiscal powers.*

To give effect to these trust powers, and enable the company to manage the funds and properties entrusted to it in such manner as to make and secure and at the same time provide an income to beneficiaries, investment powers are conferred as follows: (1) To loan money on real and personal securities. (2) To purchase, invest in, and sell stock, bills of exchange, bonds, mortgages, and other credits. (3) When moneys or securities are borrowed, or received on deposit or for investment, the bonds and obligations of the company may be given therefor. (4) To lease, hold, purchase, and convey any and all real property necessary in the transaction of its business, or which the purposes of the corporation may require, or which it shall acquire in the satisfaction or personal satisfaction of debts due the corporation under sales, judgments, or mortgages, or in settlement or in partial settlement of debts due the corporation by any of its debtors.

*Investment powers.*

With these authorizations and grants of powers, the trust company, after equipping itself with officers and agents for the safe conduct of its affairs, is ready for business.

The first trust companies organized did not have their powers so broadly or distinctly defined, nor did they need them. Before the development of modern methods of corporate finance, before the growth of the present complex organization of business, only the general trust relations were prominent. Insurance companies were the first to undertake the administration of trusts in lieu of personal trustees. Gradually, however, as trust relations became more highly developed and more frequent, the business of holding and executing trusts came to be specialized. Within the last twenty-five years trust relations and trust companies have been multiplied. The vast expansion of corporate methods of business, the advantages offered by the trust company in the service of business institutions for the registration and transfer of stocks and bonds, the practise of holding trust deeds and mortgage securities for bondholders, of receiving assignments of property for the benefit of prospective corporations which are in the hands of promoters, and for the purposes of reorganization and for the execution of voting trusts, besides the many services which they are able to render as funding agencies, fiscal and transfer agents for public as well as private corporations, in the underwriting and disposition of stocks and bonds and the disposition of moneys, the demand for such services has directed large investment capital and the best financial ability to the trust company.

*The growth of business of trust companies.*

As investment agents, the trust company acts in a double capacity. In the first place, it acts as trustee for its beneficiaries; in the second place, it has a large cash capital of its own. The inducement to the investment of money in the stock of the trust company—in making subscriptions to its capital stock—is apparent. The character of business judgment and of business enterprise necessary to the successful management of trust estates is the same as that required for the con-

*Double investment relations.*

servative investment of the funds of its managers. Capital, therefore, that is seeking first-class securities and investments would be attracted to the stock of such an institution. To return to the concrete: Let us suppose that A had $500,000 of investment funds of his own. The same considerations that would lead men with capital to invest it in the stock of a trust company would induce them as managers of the company to receive deposits from those who had funds to invest, but who were willing to take a relatively small income and be relieved of the risk and trouble of management. By offering 3 per cent for time deposits the trust company has exchanged its own credit obligation for funds deposited; by virtue of its better facilities for safe investment, the company is enabled so to invest these funds that they may yield from 4 to 5 per cent. This on a large line of deposit would also give it a handsome profit.

## CHAPTER XIV

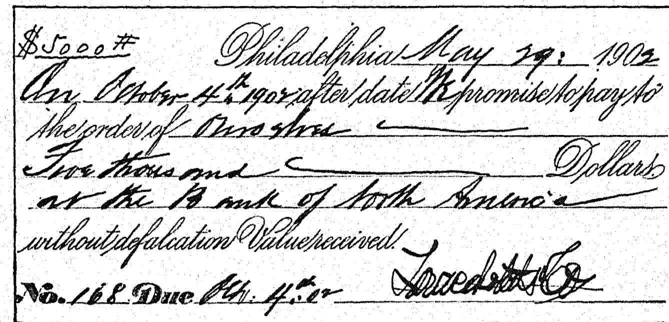
### THE BROKER AND THE BROKERS' BOARD

A BROKER is a special agent employed to make purchases or sales for another—his principal. Mr. Wanamaker wishes to borrow $500,000 for sixty days, with which to make payment on a cargo of goods received from Paris. No one person or bank would at the time have that amount of funds free for investment in sixty-day paper; moreover, from considerations of safety, it is the policy of banks and other note-buyers not to have a large proportion of their funds invested in the paper of one person or business firm.

*The note-broker.*

To find purchasers for this amount of paper on favorable terms would require Mr. Wanamaker to leave his business house and spend time elsewhere which he might profitably use in his office. Instead of doing this, he goes to a note-broker—a man who makes it his business to find customers of this kind, one who keeps in touch with the note-buying constituency. The broker knows the kind of paper that the banks and other note-buyers usually take, and about how much; at this time, in fact, he may have a long list of buyers' wants scheduled on his books. For a small commission he undertakes to sell the notes for Mr. Wanamaker. Turning to the orders of buyers scheduled on his books, he first satisfies these by setting apart enough to fill them. Let us suppose that he already has customers for $200,000 of this kind of paper. He then takes down his "'phone," and, by calling up one prospective buyer after another, has the whole remaining

amount disposed of in half an hour. His delivery clerk is then sent out with the notes, who, in exchange, brings back customers' checks, which are deposited; thereupon remittance of the amount of funds desired is made to Mr.


$5000#  Philadelphia May 29: 1902
On October 4th 1902 after date We promise to pay to the order of Ourselves
Five thousand Dollars
at the Bank of North America
without defalcation Value received.
No. 168 Due Oct. 4th 02  [illegible] & Co.

Wanamaker for settlement with his Paris house. The notes usually handled by commercial paper brokers for large houses are made in uniform amount of $5,000 each. They are drawn to the order of the "maker," and with-

## LETTER OF RELEASE.

*Philadelphia,*..........................................189

**For and in consideration** *of the sum of one dollar, to us in hand paid, the receipt whereof is hereby acknowledged,*..........................................

*agrees to release, and hereby does release,*..........................................

*from all liability as endorsers on a note of*..........................................

*dated*.......................*in the year eighteen hundred and ninety-*..........

*due*.......................*in the year eighteen hundred and ninety-*..........

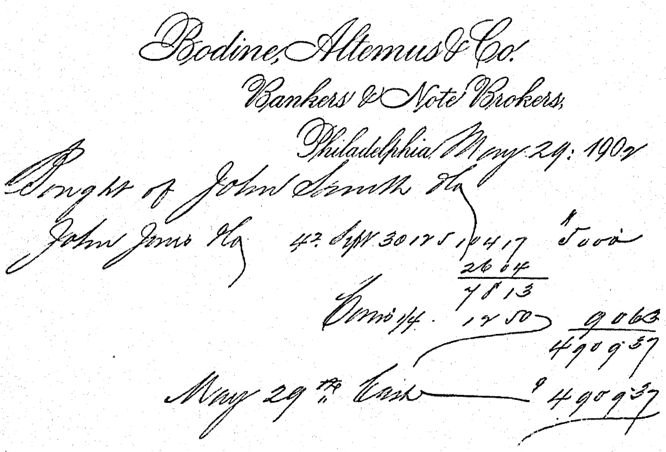
*for*..........................................*Dollars,*

*and the said*.......................*further agrees to hold the said endorsers harmless on said note.*

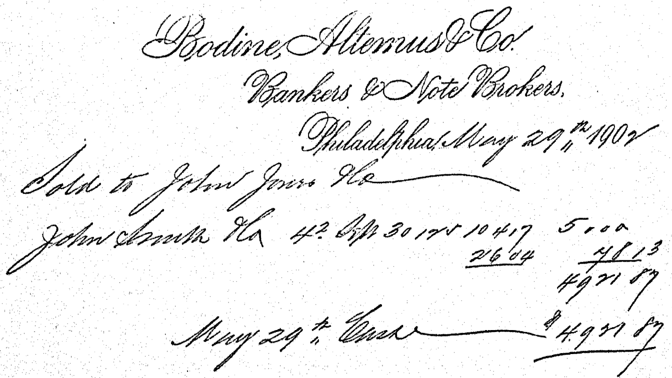
*Witness:* ______________________

out indorsement are what is known as one-name paper. When not executed to the order of the maker and a dealer

wishes to protect himself, he secures a release from responsibility on indorsement. The manner of conducting a transaction through a "commercial paper house" is illustrated by the following statements of account: The first


Bodine, Altemus & Co.
Bankers & Note Brokers,
Philadelphia May 29: 1902
Bought of John Smith & Co
John Jones & Co 4½ Sept 30 125 10417 5000
2604
7813
Com 1/4 1250 9063
4909 37
May 29th Cash $4909 37

represents that Bodine, Altemus & Co. on May 29, 1902, bought of John Smith & Co. a note executed by John


Bodine, Altemus & Co.
Bankers & Note Brokers,
Philadelphia May 29th 1902
Sold to John Jones & Co
John Smith & Co 4½ Sept 30 125 10417 5000
2604 7813
4921 87
May 29th Cash $4921 87

Jones & Co., bearing interest at 4½ per cent, due September 30, following; that the note runs 125 days, which

at $4\frac{1}{2}$ per cent amounts in interest to $104.17. Allowing for discount and commission, the total deduction to be made from the fall of the note equals $90.63. This leaves a net cash payment of $4,909.37 on purchase of the note. The second statement is one of sale by Bodine, Altemus & Co., by which it appears that the terms were exactly the same as those of purchase, except that $12.50 is added for commission.

Upon receipt of the $500,000 in funds—the proceeds of the note sale—Mr. Wanamaker has another problem to solve, viz., "How is this amount of money to be transmitted to Paris"? This may be done by drawing that amount of gold out of the bank in New York where his account is kept, and sending it by express to the parties from whom purchases of goods were made. This would cost him $1 per thousand or $500 for transportation charges. If $500,000 of the bills of New York merchants against merchants of Paris can be found, he may buy these and then send them to his Paris banking-house for collection. By so doing the cost of transporting gold to Paris would be avoided; at the same time the Paris merchants would avoid the cost of sending a like amount of gold back to New York. The matter of finding such bills against Paris merchants is given over to an exchange-broker. The exchange-broker, who has a constituency that have foreign bills for sale, telephones around from place to place, and within a short time has the desired amount. For a commission amounting to a small fraction of the cost of shipping gold, $500,000 of good trade bills are obtained.

*Exchange-broker.*

After the goods have been sold, Mr. Wanamaker may have $100,000 that he has no immediate use for in his business, and he decides to invest the amount in stocks and bonds. Looking over the securities of companies on the market, he makes up his mind that Chicago, Burlington & Quincy Consolidated 7 % of 1903, @ 102, Chicago & Northwestern Sinking Fund 6's of 1929, @ 115, and

Central of New Jersey, common, @ 150, will make good investments if they may be had at the prices named. But he does not know any one who has any of these for sale at these prices. To obtain these investments he leaves an order with a stock- and bond-broker. The order is to buy any of the stocks or bonds on the market at the prices named. At the time that the order is given none of them may be offered at the price; but within two weeks the money market becomes close, and some of the holders of securities are willing to sell at such figures that the order may be executed. The broker charges $\frac{1}{8}$ of 1 per cent for his services on delivery.

*The stock-broker.*

Again, Mr. Wanamaker, being interested in a textile factory at Worcester, may wish to purchase a stock of cotton for the year. He has contracts for cloth to fill, and desiring to take advantage of a present market for materials for manufacture, he places an order with a cotton-broker for 500 bales at 5 cents per pound. In like manner, a person desiring wheat or corn will go to a grain-broker; another, desiring petroleum, will go to an oil-broker; one wishing to lay in a supply of coal may deal with a coal-broker, etc. Any property or commodity that has a central market may be the subject of a broking business.

*The produce-broker.*

The business of broking has given rise to a peculiar form of institution known as a Brokers' Board. In early days the stock- and bond-brokers did business in much the same way that coal-brokers or real-estate-brokers do to-day. On receiving a consignment for sale they would go out on the street to find purchasers; or, receiving buying orders, they would go about from place to place to find owners who had stocks and bonds of the kind wanted, and which might be obtained at the prices offered. The result of a morning's canvass, however, might give but small return. Coming to the coffee-house for luncheon, they would meet other brokers who also had buying and selling orders. It was found by ex-

perience that more business could be transacted at luncheon, or during a half-hour meal-time smoke with brokers than by a whole day's canvass. The advantage of bringing together the buying and selling wants of a community at a meeting of brokers caused them as by common consent to meet at a central coffee-house to transact their business. But this was oftentimes unsatisfactory on account of the unreliability of some of the traders. The result was that, as business increased, an association was formed with rules governing it which would insure honorable dealings among members, and at the same time give to each member the advantage of meeting the leading brokers of the place.

*The Brokers' Board.*

The Philadelphia Stock Exchange had its beginning at a coffee-house. The sales of Government bonds and of stocks in the newly organized companies after the close of the Revolution was the business which brought it forth. London stock-broking began with the foundation of the national debt under William and Mary. Large corporate trading companies had been organized before this time, but the stocks were not traded in to such an extent as to give rise to a regularly organized broking business. With the flotation of the bonds issued for the purpose of raising funds to carry on the wars against France, and the appeals made to the public for investment in these stocks, stock-jobbing became a regular business in London. This was soon followed by the flotation of shares in companies organized for taking advantage of the new territory made free for British exploitation after the success of the English armies on the Continent. The South Sea Bubble was only one of the projects that gave rise to the issues of shares which flooded the London market and made the business of broking one of the most important branches of enterprise established in the eighteenth century. The London brokers first found rendez-

*History of stock exchanges.*

*1. Philadelphia.*

*2. The London Stock Exchange.*

vous in the Royal Exchange, a building erected during the reign of Elizabeth as a meeting-place for merchants. In 1698 these quarters were found too small, and were consequently abandoned. For a number of years brokers collected in a place made famous by them, which has since been known as "Change Alley." A coffee-house opening on this alley was their favorite retreat for social and financial chat. The New York brokers found their first central meeting-place at what has gone down in history as the "Tontine Coffee-House," at the corner of Wall and Water Streets. New York, like Philadelphia, early became a center of financial interest and, with this, for the business of stock-broking. Much conflict had grown out of the variety of commissions charged in the early transactions and the irregular dealings of brokers. The beginning of the New York Stock Exchange dates from a meeting of 24 brokers under a tree which grew opposite No. 60 Wall Street. This agreement is dated May 17, 1792, and is one providing for uniform commissions among the contracting parties. The force of such an agreement was to control the market, since the signers confined their trading operations to those who would conform to it. It was not until 1817, however, following the growth of corporations after the War of 1812, that a formal organization was effected. As business increased, with the floating of bank, canal, and railroad stocks, the outside brokers organized what was known as the "Open Board of Brokers." This was absorbed by the New York Stock Exchange in 1868, membership in the latter being increased to accommodate that of the older organization. During the civil war a special class of business grew out of the necessity for gold purchases and gold sales for foreign trade, and for the payment of the obligations of the Government. The "Gold Board," as the association of brokers having charge of this class of business is called, was incorporated as a part of the Stock Exchange in 1879.

3. *The New York Stock Exchange.*

Later the New York Mining Stock Exchange was established, to accommodate the business growing out of the speculative mania for mining shares in the '70's; and with the discovery of Leadville and other Colorado districts, a second board, called the American Mining Stock Exchange. The decline of the popularity of mining stocks forced these bodies to look for some other branch of business. The fast-growing demands for petroleum gave them an outlet. In 1885 the two mining exchanges consolidated with the old Petroleum Exchange as the Consolidated Stock and Petroleum Exchange. New York therefore has two large stock exchanges as meeting-places for brokers handling this class of purchases and sales. Not all the business, however, is done on the floors of these two boards; a large amount is transacted "on the street," as it is called—that is, the brokers not having membership in these organizations will come together as of old at some customary place, and on the sidewalk or in the street they will bicker and trade, thus making exchanges for their customers.

*The Consolidated Stock and Petroleum Exchange.*

A stock exchange need not be a corporation. The New York Stock Exchange, for example, is only a voluntary association of members. It must, however, be well organized. It must exercise complete control over those who enjoy its privileges, for it is out of the regularity of transactions that its advantages accrue. In the New York Stock Exchange there is a membership of 1,100. As the membership is full, one may obtain a seat only by purchasing it from a member. One can not become a member, however, until he has passed the most careful scrutiny of the Membership Committee regarding his credit, his financial responsibility, his business association, his reputation for honesty and fair dealing. In addition to the usual incentive for honesty in business, therefore, the stock-broker has the price of his seat as well as his whole opportunity for doing business staked on ob-

*Organization of a stock exchange.*

servance of business propriety and honorable conduct. No other class of men has the quality of business honor so highly developed. For contracts involving millions of dollars, only individual pencil memoranda are made, and deliveries of securities and remittances are conducted on these memoranda with the utmost confidence that contracts concluded by "finger-talk" will be fulfilled without question. The only possibility considered by members of the board is one of mistake, and as a precaution against this, an office clerk is sent out at the end of each day's business to compare notes with houses dealt with, upon comparison of which errors made are corrected without conflict or controversy.

*Organization of the Philadelphia Exchange.*

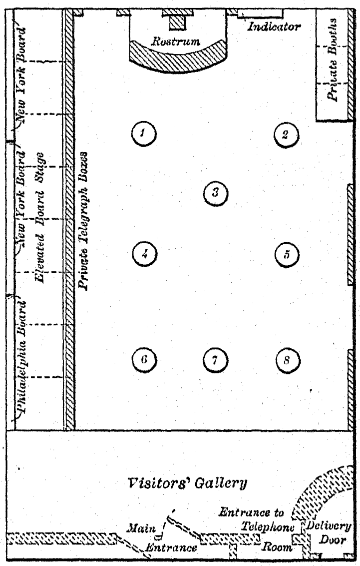
For illustration of plan of organization, the Philadelphia Stock Exchange may be used. At the head of the Philadelphia Stock Exchange is a president, who opens and closes the board at the regularly prescribed time; he preserves order, announces failures of members, gives notice of contracts unfulfilled, and attends to their execution under the rules of the board. The board opens at 10 A. M. and closes at 3 P. M. Deliveries must be made before 2.15, except on purchases and sales for cash. The board has various committees to look after different departments of business and to see that its rules are properly complied with. These committees are as follows: 1. A Governing Committee, consisting of 21 members, one-third of whom retire each year. This committee has general supervision of the affairs of the association, and is the court of final resort. 2. A Finance Committee, consisting of 5 members, which has charge of the funds of the exchange and the investment of any surplus funds in the treasurer's hands. 3. A Building Committee of 3 members, which has supervision and control of the home of the board—has charge of repairs, service, etc. 4. A Committee on Admissions, consisting of 5 members, to whom all applications for membership, for transfer, or re-admission of suspended members are re-

ferred. 5. An Arbitration Committee, consisting of 7 members, whose duty it is "to investigate and decide all claims and matters of difference between members of the exchange which may be brought before it, arising from transactions in bonds, bullion, stocks, or other securities, or from any transactions in money." This is one of the most important committees in the organization; it serves as an inner court, so to speak. Like the courts established for the government of the old incorporated trading companies, it so far controls the conduct of members and arbitrates differences between them that it is seldom any matter of controversy gets before the regular courts of law. Upon their decisions are built up rules and precedents which constitute a code for business transactions, and which by practise and common consent regulate the practises of those outside of the board and find a final place in the written decisions of the courts of record.

*The floor arrangements and office appointments of brokers.*

By reference to the plan below, an idea may be had of the floor arrangement of a board. A large part of the floor space is encumbered with nothing but what are called trading-posts. These, as the name suggests, are posts set up on the floor around which certain kinds of stocks may be traded in; as, for example, one post may be for railroad stocks, another for iron and steel stocks, another for municipal bonds, etc. (see posts numbered 1 to 8 in illustration). One having stocks or bonds for sale wishes to "offer" them on the general market; to this end he will go to the post where such stocks are traded in and cry out his "offer"; or if he wishes to purchase stocks, he may go to another post and shout out his "bid." It is this auctioneering and bidding on the floor of the board around these posts, or, in the case of a produce exchange, in the "pits," that causes the uproar so often remarked upon. The board is simply an auction-room, in which every member is an auctioneer as well as a possible

customer. As a board is a central point to which are brought the buying and selling demands of a great city or of a country, on the floor of the board may be heard the concentrated outcries and the uproar of auctioneers of the many places which otherwise would be dealing in stocks and bonds; it is this that makes a board-room seem so much like bedlam. On the floor will be found the brokers representing leading houses. At one side of the room are private boxes, in which will be found the clerks or operators, who have direct communication with the offices of members trading on the floor. From these private boxes the business of the offices will be communicated to the floor-man, and purchases or sales on the floor will be returned to the several offices. On the wall of the Philadelphia Exchange, beside the president's chair, is also an electric indicator, on which will be found consecutive numbers representing the various trading numbers of members on the board floor. When a member on the floor is wanted, a button is pressed and a light flashes out the number of this member, to which he at once responds. The member on the floor, therefore, has to have his eye constantly turned toward the indicator as well as keep in mind the whole trading situation on the floor; besides, he must keep in touch with the business demands of the office. When business is brisk this is a difficult part to play. On a side-wall of the



board-room will be recorded the transactions (purchases and sales) of the local market, as well as those of other leading boards.

*Organization of the broker's office.*

The facilities for business and the business transacted on the several boards are very largely dependent upon the organization of the broker's office. Customers are not allowed on the floor of the board. They are found in the office of the broker. In what is known as a board-room (see page 278), usually in the rear of the broker's office, are tickers, which give the quotations and the transactions on the several markets almost as soon as the business itself has been completed. The customer, therefore, is in possession of the facts of the market practically as soon as the broker himself. He is also in touch with the office members of the firm; the orders of customers for purchase and sale come in from all parts of the country to the central market.

*The speculative side of broking.*

Considerable of mystery surrounds the name broker. This is partly due to the fact that the ordinary individual does not employ a broker to make purchases and sales. When he wishes to purchase, he goes to a merchant—i. e., one who has for sale a stock of things desired. When he wishes to sell, he sells directly to a purchaser without the intervention of a special agent. The mystery associated with the name is in a measure due to the fact that a considerable part of a broker's constituency is made up of speculators. The facilities given to making purchases and sales, the arrangements for the distribution of market quotations and transactions on the various central boards, bring with them a class of dealers who endeavor to obtain an income from taking advantage of market fluctuations.

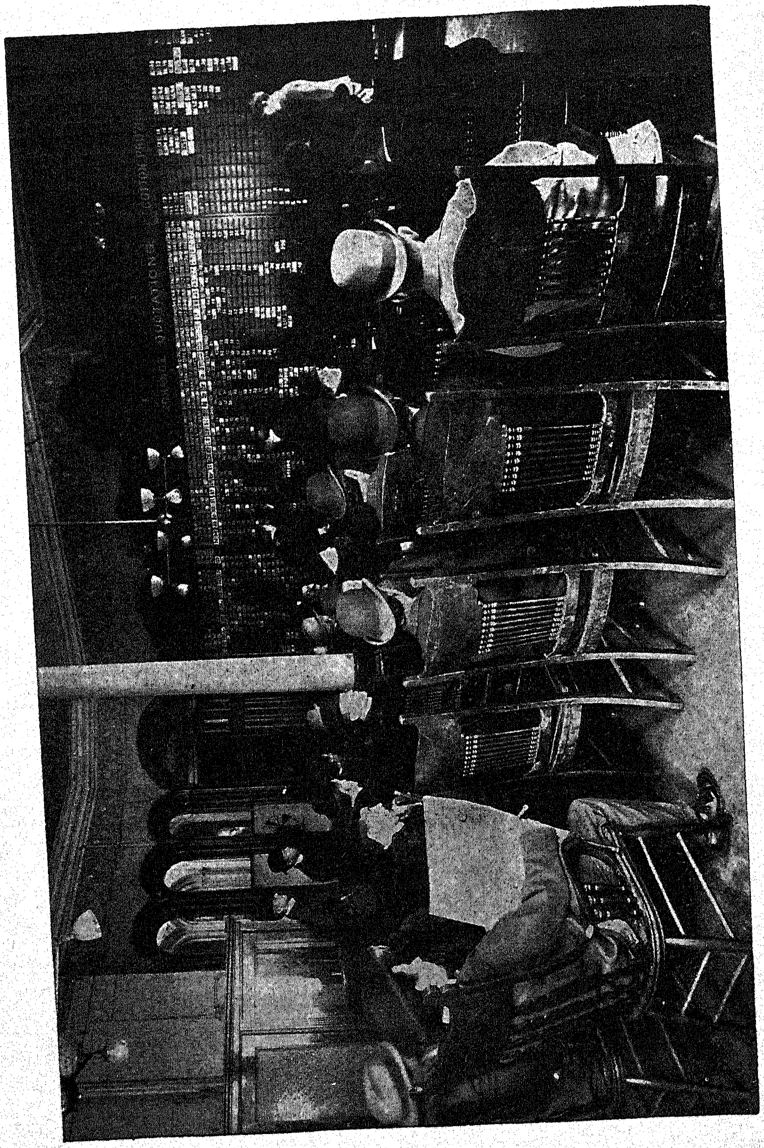
It is this that distinguishes speculation from investment. An investor is one who purchases a property or business interest outright as a result of judgment based on "what the concern has earned." His profits may come from

a rise in value of the property, or from income in the form of interest or dividends, but in the last analysis it is dependent upon the income or prospective income of the property. The speculator, however, cares not what may be the income-producing power or earning capacity of a business concern. All that he is interested in is a market fluctuation; it makes no difference whether the property becomes more or less valuable—which way the fluctuation may go—so long as he may place himself in a position to take advantage of the rise or fall. Since this is the end, and what one may call his business, it is, usually, not to his advantage to purchase and pay for the property. He would so use his trading capital that he may control as large a block of stock or other property as is possible for the purpose of getting the benefit of the change in price. He therefore buys on a margin—a margin sufficient to give him control for such a time as, in his judgment, will allow of a fluctuation in his interest. It is this kind of buying that gives rise to a large part of the business of broking. It is to this class of transactions also that much of the financial uncertainty and misfortune of the past and the present is attributable.

*Distinction between investment and speculation.*

If one should go to a broker's office day after day, there will be found a constituency in the chairs of his board-room, or going in and out, who keep an eye on the market to which may be traced a very large portion of his orders. The manner in which a market may be affected by these speculative purchases may be seen from a glance at the chart on page 280, which shows the organization of a single broker's business. This map, or sketch, represents the private wires connecting the various offices of a single concern over which streams of orders flow into the main office for execution and which find their way into the general pool on the board-floor. When fluctuations are great then trade is brisk. This is a common observation. Yet this trade is very largely a speculative

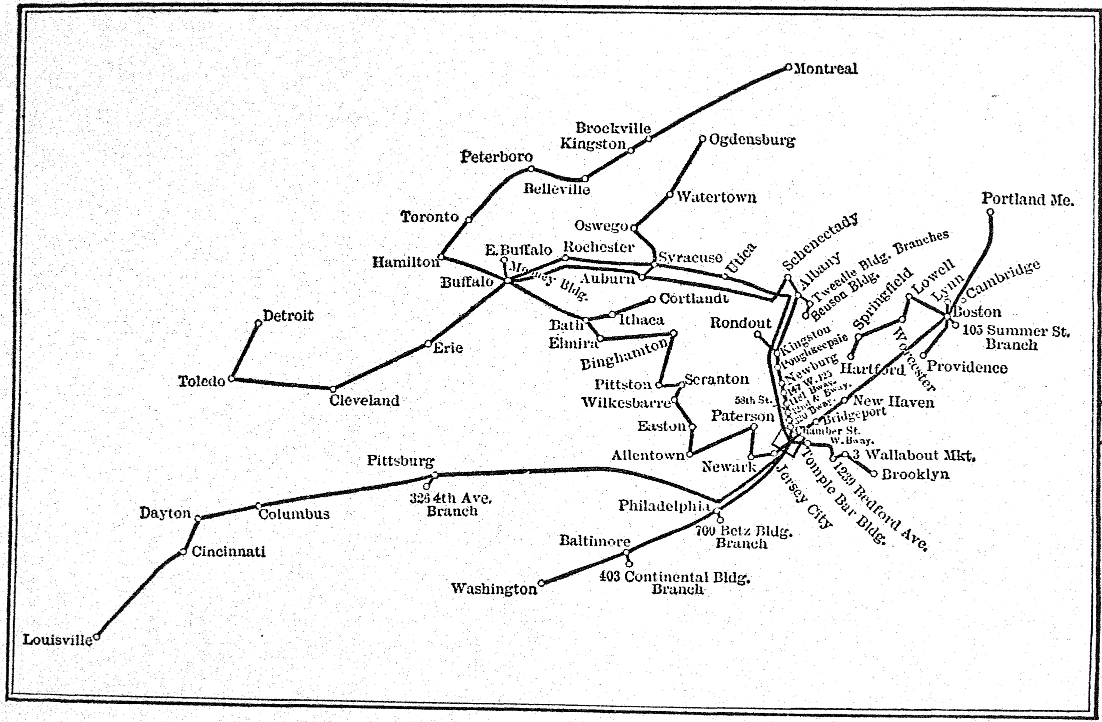
*The speculative constituency.*



one, and as fluctuations rise and fall, the capital which is used for speculative margins becomes gradually absorbed. The test of one's ability to remain in the speculation is found in his ability to keep his margins good. With these speculative orders pouring in there is a ccnstant flow of capital toward the financial centers, which finally find their way into the conservative financial institutions. The capital drawn from the purses of the speculating multitude finds final employment at the hands of the few who have the prudence and judgment necessary to conservative commercial and industrial undertakings.

*The bucket-shop.*

As a means of accommodating speculators who are unable to trade on large margins and yet who are anxious to gamble on the turn of the "wheel of fortune" in the market, a class of business has been organized which has its center in the "bucket-shop." This is nothing more nor less than a room in which quotations are given representing the fluctuations of the market which allow one to take chances on price movements. In this it does not differ from the regular speculative business in the broker's office. The methods differ, however, in that the ones conducting the office or "bucket-shop" are not in any manner regulated by a board, that they do not have their commissions determined by association rules, and that they take margins of any amount. Instead of having a wire or ticker that gives the official quotations of the central markets in a language that may be understood, and that is open to inspection, the bucket-shop has a private wire over which quotations are received by a telegraph operator. These communications may not be read by the customer, as in the case of the ticker, and therefore the operators are the only ones that have a knowledge of what is going on. At one window, therefore, will be a margin-taker—one who takes the money of customers and records the chances taken. The customer will then take a seat in the room and watch the board for movements in his stocks. Thus gambling in



Montreal
Brockville
Kingston
Ogdensburg
Peterboro
Belleville
Watertown
Toronto
Oswego
Portland Me.
Hamilton
E.Buffalo
Rochester
Syracuse
Utica
Schenectady
Albany
Tweedle Bldg. Branches
Benson Bldg.
Springfield
Lowell
Lynn
Cambridge
Buffalo
Auburn
Boston
105 Summer St.
Branch
Cortlandt
Detroit
Bath
Ithaca
Rondout
Kingston
Poughkeepsie
Elmira
Erie
Binghamton
Hartford
Worcester
Providence
Newburg
Toledo
Pittston
Scranton
Cleveland
Wilkesbarre
58th St.
New Haven
Bridgeport
Paterson
Chamber St.
W. Bway.
Easton
3 Wallabout Mkt.
Allentown
Pittsburg
Newark
Brooklyn
1239 Bedford Ave.
Temple Bar Bldg.
Jersey City
325 4th Ave.
Branch
Dayton
Columbus
Philadelphia
700 Betz Bldg.
Branch
Cincinnati
Baltimore
403 Continental Bldg.
Branch
Washington
Louisville

New York Central the stock goes up two points. The man who sits at the instrument, beside the clerk who has recorded his bid, calls out to the boy at the board what New York Central is doing. The office has it entirely within its own power to say whether New York Central goes up or down. The customer, therefore, is in a gambling-house which plays with loaded dice. In case there are others in the game who have up more money on the fall of New York Central than he had upon its rise, the returns will probably be declared in his favor. If the conditions be otherwise, he may have his margin "wiped out," and he will then be left to reflect upon whether he will "try the market again."

## CHAPTER XIV

### THE INSURANCE COMPANY

*The meaning of insurance.*

In previous chapters the nature of contracts of security has been fully discussed. Contracts of security for the payment of credit obligations are specialized forms of insurance. No better illustration of concrete insurance may be found than the forms of personal security heretofore discussed as *indorsement* and *guarantee.* Morgan has taken notes from Gates for the payment of $300,000, with interest at 5 per cent per annum. He offers to sell these to Drexel for $305,000—terms satisfactory—provided that Morgan will guarantee their payment. The guarantee of Morgan is a contract *insuring* Drexel *against loss* on account of default in the payment of the notes by Gates when due. An insurance policy is a contract wherein the insurer takes the risk incident to the happening of some event which will involve a loss.

*Credit insurance.*

The risk on which a policy is taken out may be the non-payment of a credit instrument. A concern whose business it is to issue policies on such risks is called a Credit Insurance Company. A good example of such a concern is the American Credit Indemnity Company of New York. During the year 1900 this company took risks on $15,229,031 of credit contracts, for which it received premiums to the amount of $453,420. Its losses paid were only $75,352—i. e., about one-half of one per cent of the risks taken. A wholesaler

has an opportunity to sell a bill of goods on ninety days' credit to a retail house that is not well known to him. He recognizes a profit in the transaction, but does not care to take the risk of losing the account; he therefore takes out a policy from a credit company which is in the nature of an indorsement of the credit of the retail concern. To obtain such a policy the wholesale house will make a statement or an exhibit of its books, indicating the average loss sustained during the last five years by failure of payment of credit accounts. This rate or proportion is taken as a marginal allowance or "self-insurance"—i. e., the wholesale house will carry its own risk equal to the average for the last five years. In consideration for the premium paid, the credit insurance company steps in and carries the risk in excess of this amount. The company may require that the house shall sell to concerns only which have a commercial rating specified in the policy; moreover, it may grade the premiums according to the ratings of customers. A similar form of insurance is that undertaken by companies in guaranteeing the accounts of building contractors in house-building operations. Instead of putting the retailer or contractor to the annoyance and necessity of having some friend guarantee his account, the wholesaler or house-owner pays to the insurance company a premium as consideration for the risk undertaken, and then makes this a part of the purchase price. For the insurance company to have undertaken a single risk would have been as dangerous as for an individual to have guaranteed the credit. Perhaps the loss of $75,000 incurred by the company above referred to in the course of its year's business grew out of six or seven contracts. If separate individuals had undertaken and sustained these losses it might have endangered their business and brought them to a condition of insolvency. The insurance company, however, suffered a loss on only one risk out of each five hundred taken. As shown before, the premiums received from the four hundred and

ninety-nine far exceeded the amount lost on the one policy where credit payment was not made. In fact, the premiums received by the company during the year exceeded the losses by $380,000. It is in the multiplicity of risks taken and the experience of business men as to the proportions of losses to risks taken, that a basis for conservative judgment is found; it is from these factors that probability of loss is determined.

*The Security Insurance Company.*

A highly specialized form of credit insurance is the Security Insurance Company. In this the policy is one of reinsurance of secured credit. The contracts of security to credits issued are entered into to protect purchasers of credit instruments against loss from non-payment. These credits, together with their contracts of security, which are given to assure the payment of the credit obligations, are then taken to a security insurance company, and, the risk being a satisfactory one, a policy is issued whereby the company undertakes to indemnify the owners of these secured credits against any loss uncovered by the contracts of security. In other words, the insurance company guarantees that the security is sufficient to indemnify the owner of the credit contract against loss from non-payment. The Bond and Mortgage Guarantee Company of Brooklyn is a concern of this kind.

*Title insurance.*

A holder of secured credit, however, may feel entirely safe in the value of the property against which his contract of security runs—that is, his judgment may be that the property against which he holds a lien may be adequate to provide funds with which to pay the credit claim held by him in case the debtor should fail to meet his obligation when due. The only element of uncertainty may be one of title. He is not in a position to judge whether or not the party executing the mortgage has a perfect title to the property against which the lien is given. As a means of assuring himself of this he lays the transaction before a title insurance company—a

concern whose business it is to search titles and to take risks of loss for failure of title, and to pay the expense of defending adverse claims. Upon investigation, a policy is issued and the holder of the mortgage is placed in a position of increased security. Such insurance is more often taken out by purchasers of real estate. A company of this kind usually maintains a complete set of abstracts of title to the real estate in the district where risks are taken by them. Being in a superior position to pass judgment on the nature of the risk, it may offer a low rate of insurance to the customer and at the same time protect itself against net loss by the receipts of premiums in excess of the amount paid out on policies. To illustrate: The German-American Real Estate Title Company of New York sustained losses of only $25 for the year 1900, while during that time it received in premiums $17,668. The title losses of this organization from the time of its organization have been only $4,778, while the total premiums received by the company have amounted to $598,761. The rates of insurance offered to the public are so low that one taking lien security or purchasing property outright can well afford to take out a policy which will guarantee him against individual loss; while by apportioning the losses of the few individuals among the many insured, the company is enabled to pay expenses of administration, maintain a large title plant, and have for itself a remainder in profits amounting to something like 7½ per cent per annum on the capital invested in the business.

*Different forms of risks.*

There may be as many different kinds of insurance as there are forms of risk. Insurance concerns are organized around risks incident to honesty or business fidelity; to injuries sustained in travel; accident to persons employed in factories or other hazardous callings; to sickness, casualties, and death; to risks of loss to property from fire, wind, lightning, water, burglary, breakage of glass; to dangers to vessels and car-

goes at sea, etc. The associated companies known as the Lloyds recently gave a notable illustration of the extent to which risk undertakings may be applied. For the coronation of King Edward VII many millions of dollars were to be spent in decoration and in preparation for popular spectacles, on which the financial return depended upon chances of weather, the health of the sovereign, and many other fortuitous circumstances. Before undertaking business of this kind—before building the temporary stands for spectators, placing decorations of flowers, and arranging displays of perishable goods that depended upon the occurrence of the event at a certain hour and place—business conservatism suggested the shifting of the risk to concerns whose business it was to undertake hazards and to distribute loss to individuals over the profits of the many and make them a charge against such profits. Policies on this event, it is said, were written to an amount exceeding $50,000,000. The variety of risks undertaken and the contracts made to cover loss may be illustrated in another way. In the single line known as life insurance, there are issued by the several hundred companies in existence something over 150 different forms of policies, each of which is a slightly different form of undertaking. When we consider the various classes of risks around which insurance has been organized, and the various forms of undertaking within each class, the magnitude and complexity of the business can scarcely be comprehended.

*Individual risk and speculation.*

Every *individual* insurance policy or contract is a speculation. It is a speculation of the most fortuitous kind—a form of risk that a conservative business man does not wish singly to undertake. In consideration for a premium (a very small portion of the amount involved in the risk), a company undertakes to become responsible for loss in event such loss occurs. The company is in no better position, perhaps, to estimate with business certainty the happening of an event which will

entail loss than is the individual himself. Each individual risk is a speculation to the company in the same sense as is a margin deal in a bucket-shop to the margin taker. Neither margin giver nor margin taker can tell which way the market will go; neither can comprehend to an extent which will enable him to make a conservative judgment the facts and forces which affect the market. Both of them are certain, however, that there will be fluctuations in market price. If the price of the stock dealt in goes one way, the bucket-shop will get the margin; if the fluctuation is in the other direction, the transaction yields a return to the customer. If it were possible to mark out the course of the market for the future; if any individual could procure the data of business and could so well understand it as to allow him to make a conservative estimate, then for him a purchase would not be a speculation. It is here proposed to show by what method the uncertainty of *individual* risk is reduced to a *collective* certainty—in other words, how the speculation of business life is largely reduced by the application of the principle of *collective* insurance.

*Safety of insurance.*

Each *individual* risk is based on a highly speculative uncertainty. For this no data may be procured by which a conservative judgment may be made. Business experience, however, has shown that among risks of a certain class the percentage of loss is a fairly constant one. For example, no one can tell what hour a particular building will be consumed by fire; lightning may strike it; spontaneous combustion may take place in some part where shavings have been left by the carpenters and water has entered, causing fermentation and chemical decomposition; a mouse may have taken a match to its nest and striking it with his teeth may ignite the structure; a lamp may be exploded; an electric wire may emit a spark; a hundred possibilities are present, any one of which may result in fire entailing total loss. While this is true of each and every building

in a city, it has been found by experience to be quite as true that among all buildings of a certain class, constructed of similar material, existing under similar conditions, the percentage of fires that occur within a given time—let us say a year—may be relied on. Among buildings of one class, one out of a thousand will burn down each year. This experience gives to the business man the basis for a conservative estimate—an estimate on which he can make a calculation of aggregate loss that serves as a foundation for one of the most conservative of financial institutions, the insurance company. With each class of insurance the problem for the manager or organizer of the company is one of so adapting its capital and its income as to be able to meet such losses as occur on the risks that his company has undertaken. With each class of business this adjustment must be a different one, and must be based on experience that lends itself to a calculation that amounts to a business certainty. But having made such an arrangement, he may offer to those members of the community who may suffer from *individual* loss a perfect security based on the *collection* of sharing results. If the manager of the company fail in such adaptation, or provision made for payment, then he is holding out an inducement that may lead his customer into a snare.

*The principle of life insurance.*

There is nothing more uncertain than the continuance of life in an individual, yet this uncertainty and the risk attending life have been reduced to a problem of business certainty in the organization of the life-insurance company. In 1654 Pascal and Fermat evolved the mathematical doctrine of probability, and in 1671 De Witt applied this to the probabilities of human life. It remained, however, for later years to establish from well-kept records and classified statistics the ratio of death incident to those living under definite conditions—a ratio which would serve as a premise for the application of the theory of mathematical probability to life insurance.

The result is what is known as the mortality tables. These are the mathematical conclusions, based on experience, as to probability of death among various classes of men. While the life of an individual man, therefore, is uncertain, yet it may be counted upon as a certainty that 15 deaths will occur among a thousand men twenty-one years of age who, at the time risks are taken, are termed "healthy lives." Assuming that a company were to issue one thousand policies on a class of lives on which, as a business certainty, 16 policies would have to be paid the second year, 17 the third, and so forth, the number of deaths would increase each year until the remainder had been reduced by the deaths of something like twenty years, when the annual mortality would decrease. Finally, the probability is that between the ages of 90 and 100 years the last of the one thousand would be dead.

*The "natural premium" and the "level premium" plans.*

To apply these results in such a way as to cause those who live to share the losses on those who die is the problem of life insurance. For this purpose two methods are generally employed. The first is that known as the "natural premium" or assessment method, which implies that upon the death of each member of a society or group of insured, those who still remain in the society or group will contribute a *pro rata* in order to pay the death losses on those who have died. If each of one thousand takes out a policy for $1,000, if these are young lives, and if during the first year only three out of the thousand die, than an assessment of $3.01 on the 997 remaining will be sufficient to pay the death claims. Leaving out of consideration expense of administration, etc., the purely assessment plan is an application of the principle of pro-ration of loss among survivors. The success of such a plan depends therefore upon keeping within the group or society employing the plan an increasing number of members, in order that as the policy-holders attain greater maturity of years and by death drop out, the

assessment may not rise to a prohibitive rate; for if the society does not increase, with each death the number of survivors will proportionately decrease, and the rate of assessment would necessarily rise to meet future losses until the last survivor will be required to pay an assessment of $1,000 to the one next before him, and he himself would be left without protection.

*Assessment insurance.*

Many examples of the working of this principle are found within what are known as fraternal and assessment insurance orders that provide no reserves for the payment of death claims. The Loyal Mystic Legion of America is an association organized in 1892. The record of death-rates, together with the amount of insurance in force, is shown in the following table:

| YEAR. | Amount of insurance in force. | Death-rate per 1,000. |
|---|---|---|
| 1897.................... | $5,419,000 | 2.4 |
| 1898.................... | 5,903,000 | 3.9 |
| 1899.................... | 6,350,000 | 3.9 |
| 1900.................... | 7,753,000 | 4.2 |
| 1901.................... | 8,560,500 | 6.0 |

Let us compare with this a society that was organized in 1879 which, as to insurance in force, rose to a high rank, (had outstanding something like $130,000,000 in risks,) but which in later years has been losing in numbers, and the average age of whose members has likewise largely increased. An exhibit covering the same period shows the following result:

| YEAR. | Amount of insurance in force. | Death-rate per 1,000. |
|---|---|---|
| 1897.................... | $51,612,500 | 26·9 |
| 1898.................... | 44,023,500 | 30.2 |
| 1899.................... | 37,294,500 | 32.0 |
| 1900.................... | 17,073,500 | 40.8 |
| 1901.................... | 10,736,500 | 43.3 |

These two societies may serve to illustrate the extremes in the working of a principle that is as certain as death itself. As stated before, the success of such an organization depends upon the numerical increase of its membership and the maintenance of a low *pro rata* of old lives. When, however, there is an aging of members or a decrease in numbers and a consequent rise in the rate of assessment, the result is to drive out the young and healthy lives and leave to the order only those whose age or decrepitude makes it to their interest to remain and renders them unacceptable to other companies.

*The reserve companies.*

The second principle around which the business of insurance is organized is that known as the "level premium" plan. The assessment practise is based on what is known as the "natural premium"—that is, the sum required for actual death losses incurred from year to year. These, as before noticed, increase as the insured grow older. The level premium plan provides for the collection of more than is requisite for the payment of losses in the earlier years of the policy and the accumulation of a reserve made up of this excess, which, with interest, will be large enough to make up the deficiency of later years. This fund, or reserve, is invested, and the income from the investment is set apart in dividends to increase the total amount, so that with this interest and dividends the reserve shall be $1,000 at the age of ninety-nine years, this being considered the date of termination of all policies. No better *exposé* of the working of this principle may be found than that given in an address by Mr. J. W. Hamer before the Wharton School of Finance of the University of Pennsylvania:

"As the reserve upon a policy increases, the amount at risk upon that policy decreases—the loss incurred at death being merely the difference between the accumulated reserve and the face of the policy.

"Perhaps a few figures will afford the best explanation.

"The ordinary life table premium at age twenty-one is $17.90 per $1,000, reduced by dividends. These dividends, improperly so called, are not profits, but savings derived from three sources:

"1. Collection of an interest rate greater than the assumption.

"2. A saving upon mortality.

"3. A saving upon expenses.

"The salvage from these items, as it might be termed, is, in a mutual company, ordinarily applied in reduction of the gross premium. To simplify our illustration, however, I will, with your permission, dismiss further consideration of dividends and assume that there are none.

| | |
|---|---|
| "Let us, then, turn back to the annual premium, age twenty-one of, | $17.90 |
| Deduct from this the apportionment for expenses, called the 'loading,' which is.................................... | 4.63 |
| Leaving the net premium.......................... | $13.27 |
| Out of this net premium is provided the cost of the first year's insurance............................................ | 7.05 |
| The difference...................................... | $6.22 |
| is the sum laid by at interest as the year's contribution to the reserve, reducing the amount at risk from $1,000 to $993.78. | |
| When this insured member has reached the age of fifty, he is charged the same net premium of....................... | 13.27 |
| The cost of insurance for this year has increased to.......... | 10.10 |
| Leaving contribution to 'reserve'.................... | $3.17 |

"Previous years' additions, plus interest, have raised the reserve on this policy to $303, which, deducted from $1,000, the face of the policy, has diminished the amount at risk to $697.

"The insured member having attained the age of seventy-five, is still charged the same net premium of $13.27. His reserve has reached $680.07, which, deducted from the face of the policy, $1,000, has brought the amount at risk down to $319.93, but at his advanced age the year's

charge for mortality upon even this small sum has become greater than the premium available.

"The account is then made up as follows:

| | | |
|---|---|---|
| "Reserve at the end of the previous year | | $680.07 |
| Net premium, as before | $13.27 | |
| Interest added to the reserve | 27.73 | |
| Total | | 41.00 |
| Which also added to the reserve makes a grand total of | | $721.07 |
| Deduct the estimated cost of insurance for the current year upon $319.93 | | 27.06 |
| and you have a balance or reserve of | | $694.01 |
| reducing the sum yet at risk to $305.99. | | |

"The same process is continued until age ninety-nine, when, under the actuary's table, with 4 per cent interest, the reserve equals the face of the policy. The various tables used are not identical, the American table, for instance, stopping at age ninety-five."

*Application of the two principles of life insurance.*

Many kinds of policies are offered involving combinations of assessment and reserve, of endowment and annuity, or ordinary life, tontine, and other plans, but through them and in them all may be found one or both of these two principles. The "level premium" plan, with its reserve, offers to the insured a perfect security against loss whether membership increases or decreases so long as the reserve be perfectly protected, and the laws of the several States have been framed to secure this end. The rate of insurance on the level premium plan for the earlier years of the policy is higher than that of the assessment or "natural premium" plan, yet with this increased rate it offers a security which eliminates speculative risk involved in the futurity of the company itself.

Other plans of organization and adaptations to particular lines of insurance might be discussed, but the few pages here given to the subject will allow of nothing more than a presentation of principles involved. The enormous re-

serves kept by the life insurance companies; the capital and surplus invested in fire, marine, and other forms of insurance organizations; the resources that are deemed essential to security and to the elimination of the element of speculation from a business whose purpose it is to take over the burdens of speculative risks, have all contributed to make insurance companies the largest investors and the most conservative financial concerns in business life. The risks undertaken by insurance companies in the United States amount to between fifteen and twenty billions of dollars. The resources in the hands of the life-insurance companies alone on January 1, 1901, amounted to $1,754,662,712. These companies have a premium income of $324,723,954 per annum, and from their investments an additional income in the form of interest and rentals amounting to $75,874,303, making a total annual income of over $400,000,000. In capital stock within ten years, from 1890 to 1900, the increase has been over 50 per cent, while the annual income has increased from $196,938,069 to $400,603,258. The expense of management for the same years increased from $44,190,352 to $98,892,499. The excess of income over expenditure, including death losses, for the same years show the following remarkable increase: In 1890, $62,729,898; in 1900, $133,023,157. This excess of income over expenditure indicates the enormous increment that is annually being added to that part of life insurance based on the level premium plan. Within the ten years above mentioned the admitted assets of the 76 companies now operating under the reserve plan has increased from $770,972,061 to $1,742,414,173; in other words, within ten years they have added one billion dollars to their assets.

*The financial side of insurance.*

*The investments of insurance companies.*

These assets are very largely held in the form of investments. A classification of investments is as follows:

| | |
|---|---|
| Real estate | $158,119,116 |
| Mortgages | 501,498,988 |
| United States bonds | 7,190,565 |
| Other stocks and bonds | 794,631,743 |
| Collateral loans | 64,488,774 |
| Premium notes and loans | 88,500,575 |
| Total | $1,614,429,761 |

Besides these items there appears among the assets of companies what is termed "cash in office and in bank." This item has a peculiar status. The laws of the several States require the insurance companies to make a statement of investments, assets, liabilities, etc., in order that there may be a published record of their doings. Furthermore, the various States have appointed special officers for the investigation of the condition of insurance companies for the protection of policy-holders. In the rivalry between insurance companies a point is made of the character of their assets. Nearly all of the insurance concerns make advances to their agents. With the numerous agencies scattered through the country small advances made to each will amount to millions in the aggregate. In order that these advances may not appear in their true light —in other words, that it may not be placed on record that they are doing business in this way—many of the large insurance companies, being in control of banking institutions, take to the banks under their control the notes of the various agents on which advances have been made and, for the purpose of the statement made to the public, temporarily discount these notes and have the amounts entered to their account as cash credits. These are then canceled by the return of the notes when convenience may serve after they have performed the service intended. While this may, in ordinary business experience, be considered an illegitimate practise, yet the practise itself has arisen very largely out of the rivalry between companies and the tendency of certain unintelligent inspectors to interfere in

*The cash items of insurance companies.*

what may be considered a legitimate business arrangement, and one which does not necessarily jeopardize any of the interests of policy-holders or of stockholders.

*Insurance companies as factors in the security market.*

With the enormous holdings in stocks and bonds, and with investments in such securities limited by statute of the several States, it may be well understood how it is that what are called "gilt edge" stocks and bonds command a low rate of interest or dividend return on market price paid. The successful investment agent or investment manager of a large insurance company keeps his eye constantly open for opportunity to invest in accredited stocks and bonds at a rate that will return to his company an income which will produce a dividend to policy-holders and to stockholders. Moreover, a certain *pro rata* of the funds of insurance companies are loaned to speculators on what may be termed "call" or "collateral" loans. These have as collateral security listed stocks and bonds. The Equitable of New York, for example, has outstanding on collateral loans $25,-371,587, over one-third of all the collateral loans of the combined companies. Let us suppose that a margin of ten per cent is allowed between the market price of securities held as collaterals and the amount of advance. For a company safely to make loans on a kind of collateral that is constantly fluctuating with the movements of market price, it is incumbent upon an institution making such loans—and most of the old line companies do make advances of this kind—constantly to keep watch of the market in order that the margin of safety may not be impaired. The usual custom is for such a company to have a corps of clerks whose duty it is to keep a constant record of all the stocks and bonds in which it is interested. This also serves the company as a record from which investment calculations may be made. Such power have the combined insurance companies in the market that were they to conspire to such an end, every financial concern in the country

might be brought to a condition of distress, possibly of bankruptcy. On the other hand, with the strong support of such companies the market, financial institutions, and the Government itself find in insurance companies the greatest financial security. The effect of the enormous risks undertaken by the insurance companies, therefore, is not only to relieve the business world of speculative uncertainty in the numerous relations to which it is applied, but also, by the financial conservatism adopted to secure this end, the investment companies assist very materially in steadying the market and, in time of strain, relieving financial distress.

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